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The Magic in the Tax Legislative Process

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THE MAGIC IN THE TAX LEGISLATIVE PROCESS

*Christopher H. Hanna**

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*The first thing that is learned is that deception depends entirely
upon doing things in such a manner that it seems there is no
attempt at deception.*

— *Dariel Fitzkee*¹

I. INTRODUCTION

IN enacting the tax laws, Congress and others involved in the legislative process have been accused by many, including individual members of Congress, congressional aides, and the press, of employing gimmicks and sleight of hand as part of the tax legislative process.² Some

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1. DARIEL FITZKEE, *MAGIC BY MISDIRECTION* 224-25 (1987 ed.) (1975).

2. See, e.g., John Buckley, *Estate Tax Repeal: More Losers than Winners*, 106 TAX NOTES 833 (2005); Heidi Glenn, *Bush Gets Swift Early Victory, Others May Be Slower to Come*, 91 TAX NOTES 1819, 1820 (2001) (quoting the chair of the Senate Budget Committee that the Economic Growth and Tax Relief Reconciliation Act of 2001 has enough gimmicks “to make a con artist blush”); David S. Broder, *Trillion-Dollar Gimmick; Extending*

of these so-called gimmicks include the use of non-code provisions to benefit certain taxpayers, the use of the alternative minimum tax to scale back tax benefits (and lower revenue costs), and also the use of delayed effective dates and transition rules to lower revenue costs. For example, in its November 1, 2005, letter to Treasury Secretary John Snow, the President's Advisory Panel on Federal Tax Reform, including two former U.S. senators as its chairman and co-chairman, wrote that one of its recommended tax plans "does away with gimmicks and hidden traps like the Alternative Minimum Tax."³

Magicians use the term gimmick quite often. In fact, the term "gimmick" comes from the magic arena. But magicians also use the term "fake," and almost all magical devices utilized by magicians can be classified as either gimmicks, which are generally secret devices, or fakes, which are generally visible yet not understood devices.⁴ Moreover, magicians sometimes inaccurately use the terms interchangeably; for example, using the term gimmick when the term fake is the more appropriate term. Magicians utilize gimmicks and fakes to accomplish a single purpose: to deceive and thereby entertain the audience. In the world of magic, no negative (or positive) connotations are associated with the terms gimmicks and fakes—they are merely categorizations of magical props.

It appears that much (but not all) of the so-called trickery and sleight of hand employed by those in the tax legislative process can also be classified into two broad categories very similar to the magical categorizations of gimmicks and fakes. The first category involves changes to the tax laws that are hidden from general view. More specifically, these changes

Bush's Tax Cuts Through Sleight of Hand, WASH. POST, Feb. 19, 2006, at B7; Richard A. Oppel, Jr., *House Approves Curb on Minimum Tax*, N.Y. TIMES, May 6, 2004, § A1, at 27.

3. REPORT OF THE PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM (NOV. 2005) [hereinafter PRESIDENT'S TAX ADVISORY PANEL REPORT]. President Bush appointed the panel in January 2005. See Exec. Order No. 13,369, 70 Fed. Reg. 2323 (Jan. 7, 2005), available at <http://www.taxreformpanel/executive-order.shtml>.

4. When a magician is simply using sleight of hand with regular props (such as a deck of cards or coins), then generally the magician will employ a combination of "sleights" and "subtleties" in executing the tricks. A sleight is a secret move generally requiring skill to execute successfully. See, e.g., NATHANIEL SCHIFFMAN, ABRACADABRA 410 (1997). For example, a magician may palm a card, but do so in such a manner that the audience does not suspect that the magician has stolen a card from the deck, which is concealed in the palm of the magician's hand.

A subtlety is an open move by the magician that appears fair but actually accomplishes a secret purpose. For example, assume a magician needs to reverse the order of the top three cards of the deck. This could be accomplished utilizing a subtlety. One way of doing this is for the magician to say to the spectator, "At some point in this trick, I am going to ask you to count off some cards. When I do, I want you to deal cards off the top of the deck one at a time onto the table like this." The magician then demonstrates by dealing the top three cards, one at a time onto the table. The magician then picks up the packet of three cards on the table and places them back on the top of the deck. The top three cards have now reversed position in a very open manner.

The categories of sleights and subtleties are very similar to the categories of gimmicks and fakes except that the former categories (sleights and subtleties) generally involve skill with the hands while the latter categories (gimmicks and fakes) generally involve an apparatus.

are not part of the Internal Revenue Code ("Code") even though they are tax provisions. Rather, the changes are part of the non-code tax laws, or in some cases, part of the legislative history. The second category involves changes to the tax laws that are not hidden from general view. In other words, they are not hidden changes but rather changes that are in plain view. In actuality, however, these open tax changes may not be well-understood by taxpayers and tax advisors.

Congress's use of what magicians would categorize as gimmicks and fakes obviously differs from those of a magician. Congress is not entertaining an audience. Rather, its use of gimmicks and fakes may be designed to benefit a limited class of taxpayers or to lower revenue costs. In this article, no negative (or positive) connotations are intended by categorizing various tax legislative provisions as gimmicks or fakes.

In the first part of this article, gimmicks and fakes will be defined and discussed in some detail in the area where they are most frequently utilized, conjuring or magic, and examples will be given for each of the two terms in the context of well-known magic tricks.⁵ Then the article will give examples of two broad categories of tax law changes and demonstrate that these match up nearly perfectly to the magical categories of gimmicks and fakes.⁶

Trust everybody—but cut the cards.
—Finley Peter Dunne⁷

II. GIMMICKS

According to the Oxford English Dictionary ("OED"), the word gimmick dates back to the 1920s and 1930s.⁸ The OED notes that the exact origin of the word is unknown but refers to a quote in 1936 in which the word "gimmick" is spelled "g-i-m-a-c," which is an anagram of the word "magic."⁹ The OED further notes that the word gimmick is used by magicians.¹⁰ The late John Mulholland, who was considered to be one of the leading authorities on magic, defined a gimmick as "a secret device never seen by the audience."¹¹ This definition has been generally accepted in

5. See *infra* notes 7-37 and accompanying text.

6. See *infra* notes 38-213 and accompanying text.

7. See BrainyQuote.com, Finley Peter Dunne Quotes, <http://www.brainyquote.com/quotes/quotes/f/finleypete136869.html> (last visited Mar. 13, 2006).

8. See Oxford English Dictionary, <http://www.oed.com> (last visited Mar. 13, 2006).

9. *Id.*

10. *Id.*

11. HENRY HAY, THE AMATEUR MAGICIAN'S HANDBOOK 260 (4th ed. 1982). Mulholland (1898-1970) was a celebrated stage magician and a historian of magic. He amassed one of the largest collections of magic books (now housed in The Players in New York), served as a consultant to the Encyclopedia Britannica and Merriam-Webster dictionary, and at one time was the only magician listed in Who's Who in America. He was the editor of The Sphinx magazine, the leading magic magazine of its time, from 1930 to 1953, and wrote a number of books on magic. It has been recently revealed that the reason Mulholland ended the publication of The Sphinx in 1953 was to assist the Central Intelligence Agency in teaching intelligence operatives "how to use the tools of the magician's trade—

the magic world.¹² The definition of gimmick is in direct contrast to the definition of a fake, which, according to Mulholland, is "a device seen by the audience but not understood" by them.¹³ In other words, a fake is a device that appears standard but is actually altered (that is, doctored) in some way unknown to the audience. Like his definition of gimmick, Mulholland's definition of fake has been generally accepted by magicians.¹⁴ In addition, there are a very limited number of devices that magicians use that do not fit neatly into either of the two categories.¹⁵

A couple of examples of gimmicks will illustrate their definition and at the same time demonstrate the difference between a gimmick and a fake. The late Fred Kaps, a Dutch magician who was a three-time world champion of magic, was considered to be one of the greatest magic performers of all time.¹⁶ He appeared on television many times both in the United States and throughout the world, including several appearances on the Ed Sullivan show.¹⁷ One of the tricks for which Kaps was famous was the Long Pour Salt Trick.¹⁸ In fact, this was one of the tricks he did on the Ed

sleight of hand and misdirection—to covertly administer drugs, chemicals and biological agents to unsuspecting victims." Michael Edwards, *The Sphinx and the Spy: The Clandestine World of John Mulholland*, GENII: THE CONJURORS' MAG., Apr. 2001, at 22-39.

12. It is not clear whether Mulholland originated the definition of gimmick (and fake) or was simply stating what was generally accepted in the magic world. See Hay, *supra* note 11, at 260. The late Bruce Elliott, one of magic's leading writers, defined a gimmick in a similar manner as "[a]n unseen and unsuspected device by whose aid a trick is performed." BRUCE ELLIOTT, *CLASSIC SECRETS OF MAGIC* 208 (1953). See also SCHIFFMAN, *supra* note 4, at 407 (gimmick is "[a]n item used by the magician, unbeknownst to the spectators, to create an illusion."); HENNING NELMS, *MAGIC AND SHOWMANSHIP* 128 (1969) ("A *gimmick* is a piece of apparatus which the audience never notices, and which is so secret that its existence is never suspected.").

13. HAY, *supra* note 11, at 260.

14. See *supra* note 12. Elliott defined a fake as "[a]ny object that seems to the audience to serve a visible purpose while really serving another and unsuspected function." ELLIOTT, *supra* note 12, at 207. See also SCHIFFMAN, *supra* note 4, at 407 (fake is "the gimmick, or apparatus that has been secretly altered to create the illusion."); NELMS, *supra* note 12, at 128 ("Fakes are pieces of equipment which seem fair but which are actually doctored to permit results that would be impossible if they were innocent.").

15. See *infra* notes 35-37 and accompanying text.

16. Federation Internationale des Societes Magiques (International Federation of Magic Societies), generally referred to as FISM, is an international magic organization with a number of goals, including organizing and hosting the world championships of magic. See <http://www.fism.org> (last visited Mar. 13, 2006). The world championships were first held in 1948 and then each year from 1949 to 1952. Since 1952, they have been held every three years. Kaps (1926-1980) won three consecutive world championships of magic (in 1950, 1955, and 1961—he did not compete in 1951, 1952 or 1958), the only magician to ever do so. At the moment, the standard biography of Kaps is a small pamphlet, FREDDIE JELSMA, *FRED KAPS* (1988). Rumors have been floating around the magic world that a large detailed biography of Kaps is in the works.

17. Kaps appeared on the Ed Sullivan show on February 9, 1964, which was the American television debut of The Beatles. Unfortunately, Kaps had to follow their performance and for that reason his performance has largely been forgotten. See DVD: *The Four Complete Historic Ed Sullivan Shows Featuring the Beatles* (SOFA Entertainment 2003). Kaps performed a card trick and the Long Pour Salt Trick.

18. The Long Pour Salt Trick has been described in a number of magic books. See, e.g., ROSS BERTRAM, *MAGIC AND METHODS OF ROSS BERTRAM* 90-92 (1978); ANTHONY BRAHAMS, *KEN BROOKE'S MAGIC PLACE* 195-196 (1995); LEWIS GANSON, *THE GANSON*

Sullivan show.¹⁹ At the beginning of the trick, Kaps had a salt shaker in his right hand. He opened the shaker by taking off the top, closed his left hand into a loose fist, and poured the salt into the top of his left fist. After pouring the entire contents of the salt shaker into his left fist, Kaps then opened his left hand to show that the salt had vanished.

Kaps took the empty salt shaker with his left hand and made his right hand into a loose fist. He then placed his right fist over the salt shaker and salt began to fall in a steady stream from the bottom of his right fist into the salt shaker. The salt stream continued until the salt shaker was full. Kaps put the salt shaker away but salt continued to fall in a stream from his right fist now onto the floor. Kaps would stand there for several minutes, looking embarrassed, as the salt stream continued. Kaps, not knowing what to do, would reach out into the stream with his left hand to grab some of the salt to put it into his pocket so as not to litter the stage. He would then ask the band to play to help pass the time. Finally, the salt stream would end, at which time Kaps would show that both his right and left hands were empty.

The trick required a gimmick, a secret device that Kaps had in his right hand that the audience never saw. The gimmick, typically a bulb shaped container made out of metal or rubber, was filled with salt.²⁰ In fact, the gimmick contained a tremendous amount of salt to enable Kaps to continue pouring salt onto the stage for such a long period of time. At the end of the trick, Kaps used sleight of hand to pocket the gimmick and then show his hands empty. The gimmick can be purchased at many magic shops but the real skill is in utilizing the gimmick in such a way that the audience never sees or even suspects that the performer has a secret device in his hand.²¹

Another example of a trick utilizing a gimmick is the Color Changing Handkerchief.²² In this trick, the performer shows a red handkerchief to the audience. She holds the red handkerchief with her right hand and makes her left hand into a loose fist. She then places one corner of the red handkerchief into the top of her left fist poking the handkerchief in with her right index finger. She then begins to pull a green handkerchief out from the bottom of her left fist. As she pokes more of the red handkerchief into the top of her left fist, she pulls more of the green handker-

BOOK 123-127 (1982). Bertram also gives the history of the trick, tracing it back to the 1930s. See BERTRAM, *supra*, at 160-161.

19. See *supra* note 17.

20. See generally BERTRAM, *supra* note 18, at 161 (a photograph shows five different types of gimmicks to perform the Long Pour Salt Trick).

21. Even if the audience does not see the gimmick but suspects the use of a gimmick when the magician uses sleight of hand to pocket the gimmick, then the trick may be ruined. See generally HARRY LORAYNE, REPUTATION-MAKERS 87 (1971) ("When a sleight [secret move] is executed in such a way that the spectators know (or feel) that *something* has happened, even if they don't know exactly what, you're not really fooling them.").

22. The Color Changing Handkerchief is a standard magic trick and has been described in a number of magic books. See, e.g., HAY, *supra* note 11, at 249-252; JOHN NORTHERN HILLIARD, GREATER MAGIC 591-592 (rev. ed. 1945) (1938); 3 HARLAN TARBELL, TARBELL COURSE IN MAGIC 340-345 (rev. ed. 1943) (1937).

chief out from the bottom of her left fist. To the audience, it looks like the red handkerchief is turning green as it passes through her left hand.

This trick requires a gimmick that is held in the left hand. The gimmick, generally referred to as a dye tube, houses the green handkerchief at the beginning of the trick. At the end of the trick, the gimmick will contain the red handkerchief and the green handkerchief can be handed out to the audience. Like the Long Pour Salt Trick, and really any trick that requires a gimmick, the difficulty lies in convincing the audience that no gimmick is used. The audience should not see the gimmick or even suspect the use of a gimmick. Probably the most difficult part of the trick is getting rid of the gimmick at the end of the color change in a way unseen and unsuspected by the audience.

A knowledge of conjuring tricks makes a [youngster] more alert to the trickery of the world [s]he will have to cope with in maturity.

—Karl Germain, lawyer and magician²³

III. FAKES

A fake is a device seen by the audience but not understood by them. There is generally a sense of openness to a trick when a magician utilizes a fake.²⁴ In some cases, a spectator may even be permitted to examine the fake without fear of detection that it is not legitimate. A well-known trick that utilizes a fake, as opposed to a gimmick, is the Cigarette Through Quarter.²⁵ This trick can be purchased in any magic shop, and David Blaine and David Copperfield have performed it on their television specials. The effect is as follows: a magician borrows a quarter and a

23. STUART CRAMER, *GERMAIN THE WIZARD* 99 (2002). Germain the Wizard (also known as Karl Germain) (1878-1959), whose real name was Charles W. Mattmueller, Jr., was a prominent magician in the 1910s who gave up the magic profession to become a practicing lawyer. Germain had a magic pupil late in his life and requested that his pupil never divulge the secrets that Germain revealed to him, even making the threatening statement, "If you ever write anything about me after I am gone, I will come back and haunt you." *Id.* at 31. Fortunately, for the magic profession, Germain's pupil, Stuart Cramer (1911-2003), did not honor his mentor's wishes. Shortly after Germain's death in 1959, Cramer published several books on Germain thereby allowing future generations of magicians to realize the brilliance of his mentor. See STUART CRAMER, *THE SECRETS OF KARL GERMAIN* (1962); STUART CRAMER, *THE WIZARD AND HIS LEGERDEMAIN* (1966). There has been a resurgence of interest in Germain the Wizard with the publication in 2002 of Cramer's third book on Germain entitled simply, *GERMAIN THE WIZARD*.

24. See JOHN MULHOLLAND, *MULHOLLAND'S BOOK OF MAGIC* 8 (Dover 2001) (1963) ("Because no one is suspicious about what appears to be a familiar common object, the best apparatus for magic is something which is accepted as being an article with which everyone is familiar. Such articles may be most tricky in fact, but because they appear to be ordinary are accepted as being as innocent as they appear.").

25. The "Cigarette Through Quarter" trick has been described in a number of magic books. See, e.g., RICHARD KAUFMAN, *THE COLLECTED ALMANAC* 392-95 (1992) (the late Derek Dingle's version of the Cigarette Through Quarter); JON RACHERBAUMER, *IN A CLASS BY HIMSELF: THE LEGACY OF DON ALAN* 27-35 (2000); 1 TOMMY WONDER & STEPHEN MINCH, *THE BOOKS OF WONDER* 257-60 (1996). A DVD has recently been released focusing exclusively on the Cigarette Through Quarter trick. See DVD: *Cigarette Through Quarter* (L & L Publishing 2005).

cigarette from a spectator. The magician puts one end of the cigarette against the center of the quarter and very slowly and deliberately pushes the cigarette through the middle of the quarter (in fact, part of the cigarette can be seen protruding from the rear of the quarter). The magician, if using a lighted cigarette, may even puff on the cigarette at this stage. After clearly demonstrating the cigarette has penetrated through the middle of the quarter, the magician slowly removes the cigarette from the middle of the quarter with no hole visible in the quarter once the cigarette is removed, that is, the hole in the quarter has "healed." The magician immediately hands the cigarette and quarter to the spectators for their inspection.

In order to accomplish the trick, the magician utilizes a fake quarter.²⁶ The center of the fake quarter, about the same circumference as a cigarette, is cut out and therefore separated from the rest of the quarter but is held in place by a spring hinge on the back of the quarter. One side of the quarter looks like a regular quarter and it is this side (and only this side) that the audience sees. When the cigarette is pressed against the middle of the fake quarter, the center hinges back allowing the cigarette to penetrate the center of the quarter. When the cigarette is removed, the center of the quarter snaps back into place, leaving no visible hole in the quarter. The magician switches the fake quarter for the real quarter at the beginning of the trick when the spectators do not know what to expect and then switches the quarters back at the end of the trick.²⁷

The fake quarter is often referred to as a gimmicked quarter.²⁸ Technically, that is not accurate. What makes the quarter a fake and not a gimmick is that the audience sees the quarter but does not understand what they are seeing. They believe they are seeing a regular quarter, when, actually, the quarter the audience sees has its center held in place by a spring hinge. In fact, the fake quarter can be placed for a short time on the palm of the spectator's hand, with the side that looks like a regular quarter face up, without fear of detection.

Another example of a trick utilizing a fake is the Color Changing Handkerchief. The trick was previously discussed under gimmicks, but the trick can also be accomplished through the use of a fake.²⁹ Under this method, two handkerchiefs are again used, a red one and a green

26. For a picture of the cigarette penetrating the quarter, see <http://www.elmwoodmagic.com/?nd=full&key=215> (last visited Mar. 13, 2006).

27. The most difficult part of the trick is switching quarters, particularly at the end of the trick when the spectators are closely watching the quarter and the cigarette. Magicians, however, have developed methods to switch quarters that are undetectable. See, e.g., HAY, *supra* note 11, at 143 (the DeManche change); RICHARD KAUFMAN, COINMAGIC 6-7, 10-12 (1981) (the Palm change and the Shuttle pass); 1 HARRY LORAYNE, APOCALYPSE 87 (2000) (Bob Elliott's Flipswitch).

28. See, e.g., Christopher H. Hanna, *From Gregory to Enron: The Too Perfect Theory and Tax Law*, 24 VA. TAX REV. 737, 742-43 (2005); WONDER & MINCH, *supra* note 25, at 257-60.

29. Performing the Color Changing Handkerchief utilizing a fake instead of a gimmick has been discussed in a number of magic books. See, e.g., HAY, *supra* note 11, at 250; HILLIARD, *supra* note 22, at 614-617; TARBELL, *supra* note 22, at 335-337.

one. The two handkerchiefs are sewn together, and a metal ring is sewn onto one of the corners of each of the two joined handkerchiefs. When the metal ring is up, the red handkerchief is showing and the green handkerchief is contained inside it. When the ring is down, the green handkerchief is showing and the red handkerchief is inside the green one. By moving the metal ring up and down, the handkerchief appears to change color from red to green and vice versa.

The handkerchief is a fake. The audience clearly sees it but does not understand that it is actually two handkerchiefs sewn together with a metal ring that slides up and down, showing either a red or green handkerchief depending on whether the ring is up or down. Unfortunately, the audience cannot get a good look at the handkerchief, and it certainly cannot be passed out for inspection. Consequently, the Color Changing Handkerchief is usually performed using a gimmick rather than a fake.

"Son," the old guy says, "no matter how far you travel, or how smart you get, always remember this: Some day, somewhere, a guy is going to come to you and show you a nice brand-new deck of cards on which the seal is never broken, and this guy is going to offer to bet you that the Jack of Spades will jump out of the deck and squirt cider in your ear."
"But son," the old guy says, "do not bet him, for as sure as you do you are going to get an ear full of cider."

— Damon Runyon³⁰

IV. REFLECTIONS ON GIMMICKS AND FAKES

Gimmicks and fakes are two broad categories of devices utilized by magicians to fool spectators. Although the two terms generally apply to smaller magical devices, they also apply to medium and large scale devices and illusions. For example, maybe the most famous trick of all time is the Rabbit From a Hat.³¹ Generally, the magician shows the inside of a black top hat, which appears to be empty, and then proceeds to pull a rabbit out of the hat. The trick is generally accomplished using a fake hat. More specifically, the hat has a false bottom, which hides the rabbit from the audience's view.

Probably the most famous illusion of all time is Sawing a Woman in Half.³² The trick was invented in the early 1920s and has gone through

30. HILLIARD, *supra* note 22, at 45.

31. See, e.g., JEAN HUGARD, HUGARD'S MAGIC MANUAL 278 (Dover 2001) (1939); HENRY HAY, THE AMATEUR MAGICIAN'S HANDBOOK 355 (3d ed. 1972) ("The Rabbit From a Hat has become emblematic of all conjuring."); TARBELL, *supra* note 22, at 398-403; PAUL CURRY, MAGICIAN'S MAGIC 137 (1965) ("The most famous of such tricks—probably the best known of all, if we exclude the rabbit in hat . . .").

32. See, e.g., HAY, *supra* note 11, at 388 ("The most famous illusion of modern times."); WALTER GIBSON, SECRETS OF MAGIC 116-118 (1967) ("The most sensational mystery of its day . . ."); CURRY, *supra* note 31, at 137 ("The most famous of such tricks—probably the best known of all, if we exclude the rabbit in hat—is that bizarre illusion in which it appears that a very much alive young lady is sawed in half.").

many variations over the years.³³ The audience believes the box, which the assistant lies in as the magician saws her in half, to be a regular box. But in many cases, the trick is accomplished through use of a fake box.³⁴

A very limited number of items of magical apparatus do not fit neatly into either the gimmick or fake categories.³⁵ For example, a thumb tip is a device that does not seem to fit neatly into either category.³⁶ A thumb tip is a rubber or plastic cap, shaped like the end of a thumb. It is flesh colored to blend in with a person's thumb. Many very simple but effective tricks can be performed with a thumb tip.³⁷ To illustrate, assume a magician wishes to make a cigarette disappear. One method for accomplishing this trick is by using a thumb tip. The magician begins the trick by having the thumb tip on her left thumb. She borrows a cigarette and may even light it to enhance the trick. She then forms her left hand into a fist and while doing so pulls the thumb tip off her left thumb with the fingers of her left hand so that the thumb tip is hidden in the left fist. She inserts the cigarette into the top of her left fist and directly into the thumb tip where it is crushed inside the tip. She then rubs the back of her left hand with her right fingers while at the same time her right thumb is inserted into the thumb tip. The right hand is removed with the thumb tip securely on the right thumb, and with a magical gesture, the magician opens her left hand to show that the cigarette has disappeared.

It is not clear whether the thumb tip is ever seen by the audience even though it is generally in full view during almost the entire performance of the trick. Because the thumb tip is probably not seen by the audience (through camouflage rather than concealment), it is probably a gimmick. A thumb tip is also probably a fake because it is shown to the audience as an item that is normal (that is, a thumb), when in fact it is doctored in some way. As a result, the thumb tip is one of a very limited number of magical devices that is probably both a gimmick and a fake.

*Some circumstantial evidence is very strong, as when you find
a trout in the milk.*

—Henry David Thoreau³⁸

V. GIMMICKS IN TAX LAW

If we apply the magic definition of gimmick to the tax legislative process, we see that Congress utilizes a couple of types of gimmicks. More

33. See, e.g., JIM STEINMEYER, HIDING THE ELEPHANT 275-95 (2003); ERIC C. LEWIS & PETER WARLOCK, P.T. SELBIT 131-146 (1989); MILBOURNE CHRISTOPHER & MAURINE CHRISTOPHER, THE ILLUSTRATED HISTORY OF MAGIC 259-73 (1996).

34. See, e.g., HAY, *supra* note 11, at 388; GIBSON, *supra* note 32, at 116-118; HERBERT L. BECKER, ALL THE SECRETS OF MAGIC REVEALED 77-80 (1994).

35. See HAY, *supra* note 11, at 260.

36. *Id.*

37. See generally MILBOURNE CHRISTOPHER, FIFTY TRICKS WITH A THUMB TIP: A MANUAL OF THUMB TIP MAGIC (3d ed. 1948).

38. See The Quotations Page, Henry David Thoreau Quotes, http://www.quotation-spauge.com/quotes/Henry_David_Thoreau (last visited Feb. 2, 2006).

specifically, some income tax provisions enacted by Congress are not part of the Code. In many cases, these provisions can only be found in the tax act itself and are generally referred to as non-code (or off-code) provisions. Other times, Congress may include an income tax provision in the legislative history of a tax act, such as a committee report. The legislative history is used to a large extent as clarifying guidance to the administrators who write the regulations. Like non-code provisions, a tax provision in the legislative history is not part of the Internal Revenue Code. Unlike non-code provisions, however, the legislative history is technically not part of the tax laws. But it may carry substantial weight with the Treasury Department, the Internal Revenue Service, and the courts.

A. NON-CODE PROVISIONS

Congress utilizes non-code provisions for a number of different reasons. For example, it may utilize a non-code provision to provide transitional relief. To illustrate, in the Tax Reform Act of 1986, Congress amended code section 336 to require corporations to recognize gain or loss on liquidating distributions of property. But Congress also provided transitional relief through a non-code provision for certain small business corporations liquidating in 1987 or 1988.³⁹ This transitional relief generally preserved corporate nonrecognition on liquidating distributions.⁴⁰ Congress may also utilize a non-code provision to direct the Treasury Department ("Treasury") to conduct a study of a particular area of tax law. For example, Congress, through a non-code provision in the 1986 Act, directed Treasury to conduct a study of proposals to reform subchapter C and submit a report by January 1, 1988.⁴¹ Occasionally, Congress enacts a non-code provision designed to benefit a particular industry. For example, in the American Jobs Creation Act of 2004, Congress, through a non-code provision, permitted shipbuilders to use the 40/60 percentage-of-completion/capitalized cost method for qualified naval ship contracts.⁴² Finally, Congress may use a non-code provision to sunset a tax act. For example, in 2001, Congress used a non-code provision to sunset all of the provisions contained in the 2001 Act on December 31, 2010.⁴³ In each of the above examples, Congress utilized non-code provisions rather than code provisions to avoid adding unnecessary length and complexity to the Code with respect to provisions affecting a limited number of taxpayers

39. Tax Reform Act of 1986, Pub. L. No. 99-514, § 633(d), 100 Stat. 2085, 2277-78.

40. See generally BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 11.60 (5th ed. 1987).

41. Tax Reform Act of 1986 § 634, 100 Stat. at 2282. Treasury submitted the report titled *INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS: TAXING BUSINESS INCOME ONCE* (Jan. 1992), available at <http://www.ustreas.gov/offices/tax-policy/library/integration-paper/>.

42. American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 708, 118 Stat. 1418, 1550-51.

43. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901, 115 Stat. 38, 150.

or organizations, or in the case of a sunset provision, to sunset all the provisions of the tax act utilizing only one non-code provision.

Sometimes, Congress enacts a non-code provision to benefit a single taxpayer or organization, and it is in this scenario in which the non-code provision is, in essence, a tax gimmick. The Tax Reform Act of 1986 contained hundreds of these provisions, sometimes referred to as rifle-shot transition rules or ad hoc provisions, and these are often viewed as secret (or hidden) tax breaks.⁴⁴ In an article in the *New York Times*, the reporter writes that “[i]n the old days when Representatives Dan Rostenkowski and Wilbur D. Mills ran the House Ways and Means Committee and Senators Russell B. Long and Bob Packwood were chairmen of the Senate Finance Committee, Congress often enacted hidden tax breaks . . . for specific, unidentified companies.”⁴⁵

One non-code provision that became well-known after passage of the 1986 Act provided that amounts paid by a taxpayer to one of two described higher education institutions that would qualify for the charitable deduction would not be disqualified “because such taxpayer receives the right to seating or the right to purchase seating in an athletic stadium of such institution.”⁴⁶ Congress described the two higher education institutions as follows:

(b) Described Institutions.—

- (1) An institution is described in this paragraph, if –
 - (A) such institution was mandated by a State constitution in 1876,
 - (B) such institution was established by a State legislature in March 1881, and is located in a State capital pursuant to a statewide election in September 1981 (sic),
 - (C) the campus of such institution formally opened on September 15, 1883, and

44. Rifle-shot transition rules generally refer to non-code tax provisions that provide *transitional* relief to a single or a very limited number of taxpayers. In contrast, ad hoc provisions generally refer to non-code provisions that provide *permanent* relief to a single or a very limited number of taxpayers. See, e.g., JEFFREY H. BIRNBAUM & ALAN S. MURRAY, *SHOWDOWN AT GUCCI GULCH* (1987) (discussing the events leading to the passage of the Tax Reform Act of 1986 and the numerous beneficiaries of non-code provisions enacted as part of the Act); Lawrence Zelenak, *Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?*, 44 TAX. L. REV. 563 (1989).

Congress has in the past enacted ad hoc provisions *in the Code* designed to benefit a single taxpayer. However, the more modern method of benefiting a particular taxpayer is accomplished through non-code provisions. See, e.g., William L. Cary, *Pressure Groups and the Revenue Code: A Requiem in Honor of the Departing Uniformity of the Tax Laws*, 68 HARV. L. REV. 745, 747-48 (1955); Note, *Tax Equity and Ad Hoc Tax Legislation*, 84 HARV. L. REV. 640 (1971); Stanley S. Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145, 1147 (1957) (old section 1240 of the Internal Revenue Code of 1954, entitled “Taxability to Employee of Termination Payments,” originally introduced in 1951, was enacted with the intent of benefiting only two individuals: Louis B. Mayer, retired vice-president of Loew’s Inc., and one other executive in the company).

45. David E. Rosenbaum, *The Fine Print: The Penney Paragraph; Tax Bill Kills Obscure Rule That Aided One Company*, N.Y. TIMES, June 2, 2001, § A6, at 10.

46. Tax Reform Act of 1986, § 1608, 100 Stat. at 2771.

- (D) such institution is operated under the authority of a 9-member board of regents appointed by the governor.
- (2) An institution is described in this paragraph if such institution has an athletic stadium –
 - (A) the plans for renovation of which were approved by a board of supervisors in December 1984, and reaffirmed by such board in December 1985 and January 1986, and
 - (B) the plans for renovation of which were approved by a State board of ethics for public employees in February 1986.⁴⁷

A little bit of research shows that the description of the first higher education institution appears to describe the University of Texas.⁴⁸ The description of the second higher education institution perfectly describes Louisiana State University ("LSU").⁴⁹ Generally, this non-code provision provided more favorable tax treatment to supporters of the University of Texas and LSU than supporters of other higher education institutions.⁵⁰ It has been suggested that Representative J.J. Pickle of Texas and Senator Russell Long of Louisiana were primarily responsible for enacting this provision.⁵¹

A second well-known, non-code provision in the 1986 Act did mention the beneficiary of the provision by name.⁵² This provision provided as follows:

Notwithstanding any other law or any rule of law (including res judicata, laches, or lapse of time), in the case of any real property or personal property located in Bangkok, Thailand, which –

- (1) was owned by James H. W. Thompson at the time of his death, and
- (2) has been transferred to the Jim Thompson Foundation (also known as the J.H.W. Thompson Foundation), a charitable foundation established in Thailand for the purpose of operating a museum consisting of such real and personal property,

47. *Id.*

48. See Zelenak, *supra* note 44, at 565 n.9.

49. *Id.*

50. This non-code provision was repealed by section 1016(b) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342, 3575.

Sometimes, a non-code provision enacted to benefit a particular taxpayer may become detrimental as a result of changes to the tax laws. Apparently, that happened to J.C. Penney. See Rosenbaum, *supra* note 45 (a non-code provision enacted in the 1986 Act to benefit J.C. Penney became detrimental to J.C. Penney as a result of changes to the tax laws in 1996; however, J.C. Penney was unable to have Congress repeal the 1986 non-code provision until 2001).

51. See, e.g., Zelenak, *supra* note 44, at 565 n.9; Rose Gutfield, *Athletic Gifts to Universities Arouse the IRS*, WALL ST. J., October 20, 1986, at 1. Representative Pickle, a Democrat, was a member of the Ways and Means Committee from 1974 until his retirement from Congress in 1995. Senator Long, also a Democrat, was a member of the Senate Finance Committee from 1953 until his retirement from the Senate in 1987 and was the committee's chairman from 1966 until 1981.

52. See, e.g., Kenneth H. Ryesky, *Tax Simplification: So Necessary and So Elusive*, 2 PIERCE L. REV. 93, 98-99 (2004); BIRNBAUM & MURRAY, *supra* note 44, at 240.

such property shall be treated, for purposes of section 2055 of the Internal Revenue Code of 1954 (relating to deductions for transfers for public, charitable, and religious uses), as having been transferred as a bequest or a devise directly from the estate of James H.W. Thompson to the Jim Thompson Foundation and the value of such property included in the gross estate shall be deducted from the gross estate of James H.W. Thompson for purposes of the tax imposed by section 2001 of such Code.⁵³

James Thompson was a well-known American businessman who developed the silk industry in Thailand after World War II.⁵⁴ He mysteriously disappeared in 1967 while taking a stroll through the woods in Malaysia.⁵⁵ Thompson's property in Bangkok, which was initially bequeathed to his nephew, was eventually transferred to a charitable organization known as the Jim Thompson Foundation.⁵⁶ Because Thompson's property was indirectly transferred to the Jim Thompson Foundation, the so-called Jim Thompson provision was inserted into the 1986 Act to ensure that Thompson's estate received a charitable deduction for purposes of the estate tax.⁵⁷

Non-code provisions, like the ones contained in the 1986 Act benefiting the supporters of the University of Texas, LSU, and the estate of Jim Thompson, are hidden in the sense that they are not part of the Internal Revenue Code. A person researching the tax laws by focusing on the Code itself, which is almost always the case, will not find a particular non-code provision.⁵⁸ That person must also research the tax acts to discover the non-code provisions. As a result, a person would have to research each tax act to find a particular non-code provision or be informed in some way as to which tax act contains the non-code provision in question. And, of course, once a person finds the tax act that contains the relevant non-code provision, some more work may need to be done if the description contained in the non-code provision does not easily describe the taxpayers or organizations benefiting from the provision, such as the non-code provision benefiting the University of Texas and LSU.⁵⁹ Finally, additional research must be done to determine if the particular non-code provision is still effective or whether it has been repealed.⁶⁰

53. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1423, 100 Stat. 2085, 2717.

54. See Jim Thompson Life & Legend, <http://www.jimthompsonhouse.org/life/index.asp> (last visited Sept. 1, 2005).

55. *Id.* Several books have been written on Thompson and what may have happened to him regarding his disappearance in Malaysia. See, e.g., WILLIAM WARREN, JIM THOMPSON THE UNSOLVED MYSTERY (2001); EDWARD ROY DESOUZA, SOLVED! THE "MYSTERIOUS" DISAPPEARANCE OF JIM THOMPSON, THE LEGENDARY THAI SILK KING (2004).

56. See The Jim Thompson House, <http://www.jimthompsonhouse.org/museum/index.asp> (last visited Sept. 1, 2005); Ryesky, *supra* note 52, at 98.

57. See I.R.C. § 2055 (West 2006).

58. Some Code publications contain annotations that will include some, but not all, non-code provisions. And, of course, the intended beneficiaries of a particular non-code provision will generally be aware of it.

59. See *supra* notes 46-51 and accompanying text.

60. For example, the non-code provision benefiting supporters of the University of Texas and LSU was repealed by Congress in 1988 by utilizing a second non-code provision.

It is true that non-code provisions can be found if the relevant tax act is researched. Gimmicks in magic, however, are secret devices that should, as a general rule, never be seen no matter how hard one looks.⁶¹ So arguably, non-code provisions differ from gimmicks in this manner. But maybe that is not entirely accurate. Perhaps a more relevant statement is that gimmicks in magic can be seen if one does more research. If the spectator moves from being in front of the magician to almost directly behind the magician, in many cases, the gimmick used in the Long Pour Salt Trick becomes visible as does the dye tube used in the Color Changing Handkerchief. In a similar manner, non-code provisions become visible if one looks "behind the scenes" by going to the original tax act. In addition, once one becomes familiar with the use of non-code provisions, it becomes much easier to be on notice and detect the use of such provisions in the future, in much the same manner as an individual who is knowledgeable about magic can detect the magician's use of various gimmicks in the performance of his tricks.

Of course, non-code provisions differ from gimmicks in magic in that the magician is trying to deceive the audience through the use of a gimmick. In contrast, many non-code provisions are utilized not for a deceptive purpose but rather for providing transitional relief, directing Treasury to conduct studies, or providing tax relief for an entire industry. Generally, Congress utilizes non-code provisions rather than Code provisions to avoid adding greater length and complexity to the Code. But when non-code provisions are enacted to benefit a single taxpayer or organization (particularly if the taxpayer or organization is not described by name but rather by characteristics), then arguably it becomes more in the nature of a deceptive type of tax gimmick, similar to the gimmick in the Long Pour Salt Trick.

B. LEGISLATIVE HISTORY

A second type of gimmick that Congress uses is placing a tax law provision benefiting a single or a limited number of taxpayers in the committee reports, which are part of the legislative history to a tax act, and not in the Code. This type of tax gimmick is not used very often. Probably, the main reason for its limited use is that the committee reports are not part of the enacted tax laws but merely an explanation of the newly enacted Code language.⁶² As a result, it may be possible that a court would give

Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 1016(b), 102 Stat. 3342, 3575.

61. If the audience catches a brief glimpse of a gimmick, magicians refer to this as flashing. Magicians will practice a trick utilizing a gimmick for hours, many times in front of a mirror, to eliminate flashing. See, e.g., Schiffman, *supra* note 4, at 407.

62. See, e.g., BORIS I. BITTKER & LAWRENCE LOKKEN, 1 *FEDERAL TAXATION OF INCOME, ESTATES & GIFTS* ¶ 4.2.2 (3d ed. 1999); Michael A. Livingston, *Congress, the Courts, and the Code: Legislative History and the Interpretation of Tax Statutes*, 69 TEX. L. REV. 819 (1991); Samuel B. Sterrett, *Use of Industry Definitions in Interpretation of the Internal Revenue Code: Towards a More Systematic Approach*, 16 VA. TAX REV. 1 (1996).

little to no regard to the legislative history.⁶³ But, as a general rule, a provision in the committee report carries a significant amount of weight with the Treasury Department, the Service, and the courts.⁶⁴

The legislative history to a tax act generally includes the committee reports from the House Ways and Means Committee and the Senate Finance Committee, hearings on the proposed bills, and a conference report with its statement of managers. The committee reports typically provide an explanation of current law, reasons for the change, and an explanation of the proposed legislation. The staff of the Joint Committee on Taxation drafts each of the committee reports with input from Treasury's Office of Tax Policy; however, the staffs of the House Ways and Means Committee and Senate Finance Committee have the final authority as to the language contained in each of their respective committee reports as well as the conference report. In addition, after a tax bill is enacted into law, the Joint Committee staff often drafts a "General Explanation" of the newly enacted law.⁶⁵

Congress's use of the legislative history to benefit a particular taxpayer can be illustrated by a recent example from the American Jobs Creation Act of 2004.⁶⁶ As part of this tax act, Congress enacted a deduction for domestic manufacturers.⁶⁷ More specifically, the deduction is "an amount equal to nine percent of the lesser of—(A) the qualified production activities income of the taxpayer for the taxable year, or (B) taxable income for the taxable year."⁶⁸ Qualified production activities income is based on domestic production gross receipts, which is defined as includ-

63. U.S. Supreme Court Justice Antonin Scalia is probably the most well-known opponent to the use of legislative history in interpreting statutes. See generally BITTKER & LOKKEN, *supra* note 62, ¶ 4.2.2 ("Although the practice is now common, Mr. Justice Scalia has revived controversy over the issue by spearheading a movement against extensive use of legislative history.").

64. Judge Richard A. Posner, for example, wrote in one tax case:

Legislative history is in bad odor in some influential judicial quarters . . . but it continues to be relied on heavily by most Supreme Court Justices and lower-court judges; and in the case of statutory language as technical and arcane as that of the DISC provisions, the slogan that Congress votes on the bill and not on the report strikes us as pretty empty. Even advised by his personal staff a member of Congress would have great difficulty figuring out the purport of 26 U.S.C. § 994(a)(1) without the aid of the committee reports. If he (or his staff) cannot rely on them as a guide to the meaning of the statute, we are not sure what he is supposed to do.

Archer-Daniels-Midland Co. v. United States, 37 F.3d 321, 323-34 (7th Cir. 1994), *cert. denied*, 514 U.S. 1097 (1995). See, e.g., BITTKER & LOKKEN, *supra* note 62, ¶ 4.2.2; Livingston, *supra* note 62; Sterrett, *supra* note 62.

65. The General Explanation, published by the Joint Committee staff after legislation has been enacted, is generally referred to as the Bluebook because the publication has a blue cover. Although often cited in court cases and administrative rulemaking, the Bluebook is generally not considered to be part of the legislative history because it is a post-enactment explanation of the newly enacted law. See, e.g., BITTKER & LOKKEN, *supra* note 62, ¶ 4.2.2; Livingston, *supra* note 62; Sterrett, *supra* note 62.

66. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

67. I.R.C. § 199 (West 2006).

68. I.R.C. § 199(a)(1). The deduction is phased-in over a five year period from 2005 to 2009, becoming fully phased-in beginning in 2010. I.R.C. § 199(a)(2).

ing gross receipts "derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property which was manufactured, produced, grown, or extracted by the taxpayer in whole or significant part within the United States."⁶⁹ However, domestic production gross receipts do not include gross receipts from the sale of food and beverages prepared by the taxpayer at a retail establishment.⁷⁰ Qualifying production property includes tangible personal property.⁷¹

As part of the legislative history to the domestic manufacturing provision, Congress included a lengthy footnote apparently intended to benefit a particular taxpayer. This footnote has generally been referred to as the "Starbucks footnote," with, of course, the implication being that the intended beneficiary of the footnote was Starbucks.⁷² As a result, the Starbucks footnote could be viewed as a tax gimmick—a provision benefiting Starbucks that is hidden from general view.⁷³ In the footnote, Congress noted that food processing is generally a qualified production activity but does not include activities carried out at retail establishments.⁷⁴ Congress then noted that a taxpayer "may own facilities at which the predominant activity is domestic production . . . and other facilities at which [the taxpayer] engage[s] in the retail sale of the taxpayer's produced goods and also sell[s] food and beverages."⁷⁵ Congress then gave an example of a taxpayer that buys coffee beans and then, at the taxpayer's facility, roasts and packages those beans.⁷⁶ The taxpayer then sells the roasted coffee through unrelated third party vendors and also at the taxpayer's own retail establishments.⁷⁷ Congress concluded that gross receipts from the sale of the roasted coffee are qualified domestic production gross receipts.⁷⁸ As a result, the roasting and packaging of coffee beans qualifies the taxpayer for the manufacturing deduction. In addi-

69. I.R.C. § 199(c)(4)(A). Domestic production gross receipts also includes the lease, rental, license, sale, exchange or other disposition of any qualified film produced by the taxpayer, electricity, natural gas, or potable water produced by the taxpayer in the United States, construction performed in the United States, and engineering or architectural services performed in the United States for construction projects in the United States.

70. I.R.C. § 199(c)(4)(B)(i). It also does not include gross receipts from the transmission or distribution of electricity, natural gas, or potable water. I.R.C. § 199(c)(4)(B)(ii).

71. I.R.C. § 199(c)(5). It also includes computer software and sound recordings. *Id.*

72. See, e.g., Shailagh Murray & David Wessel, *Corporate Tax Bill Passes Senate, Goes to President*, WALL ST. J., Oct. 12, 2004, at A1; Howard Gordon, *Tax Talk*, DESERT SUN, Oct. 21, 2004, at 2E; Janet Novack, *Burgers, Snow and Pork*, FORBES, Nov. 15, 2004, at 68.

73. It is interesting that in its Bluebook, the Joint Committee staff moved the Starbucks footnote into the text of their explanation of the domestic manufacturing deduction. See STAFF OF THE J. COMM. ON TAXATION, 108TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 108TH CONGRESS 172-73 (Comm. Print 2005). In addition, the Joint Committee staff added language seeming to apply the principles of the Starbucks footnote on a more wide scale basis rather than simply to food and beverage operations. *Id.* at 172. Treasury has picked up on the language contained in the Bluebook and incorporated it into its proposed regulations under code section 199. Income Attributable to Domestic Production Activities, 70 Fed. Reg. 67,220, 76,296-97 (Nov. 4, 2005).

74. H.R. REP. NO. 108-755, at 272 n.27 (2004) (Conf. Rep.).

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

tion, the taxpayer, at its retail establishments, sells brewed coffee and other foods. Congress concluded that gross receipts from the sale of brewed coffee and other foods did not qualify as qualified domestic production gross receipts; however, the taxpayer may allocate part of the gross receipts from the sale of the brewed coffee as qualified domestic production gross receipts to the extent of the value of the roasted coffee beans used to brew the coffee.⁷⁹

Utilizing the legislative history to benefit Starbucks is very similar to using non-code provisions to benefit particular taxpayers or organizations, such as the supporters of the University of Texas, LSU, and the estate of Jim Thompson.⁸⁰ In each case, the provision is hidden in the sense that it is not part of the Code. One very big difference between the legislative history and non-code provisions, however, is that non-code provisions are part of the law, while the legislative history is not.

C. NON-CODE PROVISION COMBINED WITH LEGISLATIVE HISTORY

Sometimes Congress will utilize both a non-code provision and the legislative history of that provision in providing a benefit to a particular taxpayer. For example, in 1997, Congress enacted a non-code provision as part of the Taxpayer Relief Act of 1997 to benefit the National Railroad Passenger Corporation ("Amtrak").⁸¹ This non-code provision was accompanied by language in the committee reports.

As part of the 1997 Act, Congress amended the Code to provide that net operating losses could be carried back only two years (rather than three years under prior law) and carried forward twenty years (rather than fifteen years under prior law).⁸² As part of the same tax act, Congress, through a non-code provision, provided that Amtrak could, in es-

79. *Id.*

80. Unlike the non-code provision benefiting supporters of the University of Texas and LSU, the Starbucks footnote seems to be consistent with the statutory language of the domestic manufacturing provision in code section 199. In other words, rather than giving a benefit to Starbucks completely at odds with the statute, the Starbucks footnote is more of a clarifying provision.

Another footnote in the legislative history to the domestic manufacturing deduction provision appears to provide a tax benefit to a limited number of taxpayers in apparent conflict with the statutory language of code section 199. H.R. REP. NO. 108-755, 266 n.9. Under footnote nine, referred to as the "agriculture footnote," domestic production gross receipts include gross receipts "from any sale, exchange or other disposition of agricultural products with respect to which the taxpayer performs storage, handling or other processing activities (other than transportation activities) within the United States, provided such products are consumed in connection with, or incorporated into, the manufacturing, production, growth or extraction of qualifying production property (whether or not by the taxpayer)." *Id.* at 266 n.9. As a result of this footnote, a taxpayer who grows or produces agricultural products outside of the United States and then stores the products in the United States may qualify for the domestic manufacturing deduction (as long as the agricultural products "are consumed in connection with, or incorporated into, the manufacturing, production, growth or extraction of qualifying production property (whether or not by the taxpayer)"). This footnote appears to be contrary to the statutory language of code section 199.

81. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 977, 111 Stat. 788, 899.

82. See *id.* § 1082(a), 111 Stat. at 950.

sence, carry its net operating losses back against the pre-1971 tax imposed against its predecessor companies. Congress provided this result by treating Amtrak as having paid tax for its first two taxable years ending after September 30, 1997, equal to the lesser of: (1) thirty-five percent of Amtrak's aggregate net operating loss carryforwards to its first taxable year after September 30, 1997; (2) the aggregate net tax liability for pre-1971 tax years of Amtrak's predecessor railroads; or (3) \$2.323 billion.⁸³ As a result, Amtrak would receive tax refunds up to \$2.323 billion over a two-year period beginning with its first taxable year ending after September 30, 1997. Congress enacted the non-code provision to benefit Amtrak in lieu of a direct appropriation of funds to Amtrak, which would have required approval by the Congressional Appropriations Committees.

Part of the tax benefit Congress provided to Amtrak was contained in the legislative history. More specifically, the conference report provided that "Amtrak's earnings and profits will be increased by the amount of the [tax] refund. However, the conferees expect that this amount will not be included in adjusted current earnings for alternative minimum tax purposes, consistent with Treas. Reg. sec. 1.56(g)-1(c)(4)(ii)."⁸⁴ While excluding the tax refund from adjusted current earnings ("ACE") is a reasonable interpretation of the non-code provision, it is not the only possible interpretation. The legislative history removes any doubt that excluding the refund from ACE is the proper congressional interpretation.

How hard I find it to see what is right in front of my eyes.

— Ludwig Wittgenstein⁸⁵

VI. FAKES IN TAX LAW

Congress has enacted numerous provisions in the tax laws that, utilizing magic definitions or classifications, would be categorized as fakes. In other words, these provisions are open and straightforward, but in actuality may accomplish a purpose not easily or readily understood by taxpayers or even tax advisors. Two examples will illustrate the use of fakes in the tax laws: (1) the use of the alternative minimum tax ("AMT") to limit tax benefits, and (2) cutting income taxes as a method of moving from an income-based tax system to a consumption-based (or wage-based) tax system.

83. See *id.* § 977(a)(1), (a)(3), (b), 111 Stat. at 899. Amtrak also would be required to reduce its NOL carryovers in an amount equal to the deemed tax paid divided by 0.35. *Id.* § 977(d)(1).

84. H.R. REP. NO. 105-220, at 511 (1997) (Conf. Rep.).

85. LUDWIG WITTGENSTEIN, *CULTURE AND VALUE* 39 (G. H. Von Wright ed., Peter Winch trans., 1980).

A. ALTERNATIVE MINIMUM TAX

A technique to lower the revenue cost of a particular tax provision (or tax bill) benefiting taxpayers is to have the provision unavailable for purposes of the AMT so that many taxpayers do not receive the full benefits of the provision.⁸⁶ In magic terms, the AMT is being used as part of a fake similar to the use of a fake quarter in the Cigarette Through Quarter trick. More specifically, in the Cigarette Through Quarter trick, the magician shows the fake quarter and represents it to be a real quarter, when in actuality and unknown to the audience, it has a hole in it to allow a cigarette to penetrate it. In a similar manner, a tax provision providing a benefit to taxpayers appears to be a real benefit and is represented as such; however, unknown to almost all taxpayers, it is unavailable for purposes of the AMT, thereby eliminating some if not much of the tax benefit. In other words, the provision providing a tax benefit is doctored in a way (through use of the AMT) that is not understood by taxpayers. One Democratic congressional tax aide has credited the 1996 presidential campaign of former Senator Robert Dole with establishing the idea of promising a large tax benefit in which a large portion of the benefit never materializes because of the AMT.⁸⁷ As a result, the AMT fake is at least ten years old but is still in use today.⁸⁸

In understanding how the AMT is used as a fake, it is helpful to understand some of the history and mechanics of the AMT.⁸⁹ In 1969, Congress enacted the predecessor of the current AMT in response to Treasury Secretary Joseph Barr's public statement that, in 1967, 155 taxpayers had adjusted gross income ("AGI") of \$200,000 or more but no

86. See, e.g., John Buckley, *The Tangled Web of the Individual AMT*, 108 TAX NOTES 347, 348 (2005) ("the explosion in the AMT is caused by the deliberate and conscious use of the AMT to reduce the budgetary cost of recent tax cuts"); Mark Prater & Christy Mistr, *Untangling the Web of the Individual AMT: A Priority of the Highest Order*, 108 TAX NOTES 699, 702 (2005) (noting that Buckley is "probably overstating" the deliberate use of the AMT to reduce the budgetary cost of recent tax cuts, but acknowledging that there may be validity to Buckley's claim that the AMT is being used for mischief.) Buckley is chief minority tax counsel to the House Ways and Means Committee. Prater is chief majority tax counsel to the Senate Finance Committee, and Mistr is majority tax counsel to the Senate Finance Committee. Prater & Mistr, *supra*, at 699.

87. See Buckley, *supra* note 86, at 349 ("The 1996 presidential campaign of former Sen. Robert J. Dole established the pattern for future tax cut legislation: Promise large tax cuts in the big print of the proposal, use the fine print of the AMT to reduce its budgetary cost, and hope that it is too complicated to be understood."). See also Martin A. Sullivan, *Millions More Would Pay AMT Under Dole Plan*, JCT Says, 72 TAX NOTES 1467 (1996).

88. See generally Lawrence Zelenak, *Of Prius Buyers, Blue States, Consumer Energy Credits, and the Alternative Minimum Tax*, 109 TAX NOTES 657, 661 (2005) (three new consumer energy credits effective January 1, 2006 are not creditable for AMT purposes; rather than simply a revenue saving purpose, however, maybe the Republican-controlled Congress imposed the AMT limitation on the credits as a way of "appear[ing] to be evenhandedly granting a subsidy to all energy-saving consumers, while in fact denying the subsidy to as many Democrats as possible. . . .").

89. For a thorough discussion of the history and mechanics of the AMT, see DANIEL J. LATHROPE, *THE ALTERNATIVE MINIMUM TAX* (1994).

taxable income, including 21 taxpayers with AGI above \$1 million.⁹⁰ These taxpayers utilized a number of preference items, which are certain exclusions and deductions that reduce taxable income without reducing economic income.⁹¹

In order to address these concerns, Congress, in December 1969, enacted a "minimum tax."⁹² Under the minimum tax, a taxpayer's preference items above an exemption amount were subject to a separate ten percent tax in addition to the taxpayer's regular income taxes. A few years later, Treasury released another report showing that, in 1974, 244 taxpayers had AGI of \$200,000 or more but no taxable income.⁹³ Partly in response to this report, in 1976, Congress made a number of changes to the minimum tax. In 1978, Congress enacted the AMT and, four years later, expanded the AMT (and correspondingly repealed the minimum tax). Under the AMT, a taxpayer would, in essence, pay the greater of his regular income tax liability or his AMT liability. Congress made a number of further changes to the AMT as part of the Tax Reform Act of 1986 and in subsequent tax acts in the 1990s.

Generally, the AMT is a parallel tax system.⁹⁴ A taxpayer must compute her taxes first under the regular income tax system and then under the AMT system. The taxpayer is then liable for the regular income tax and the excess (if any) of the tentative minimum tax over the regular income tax.⁹⁵ For example, if a taxpayer computes her regular income taxes to be \$5,300 and her tentative minimum tax to be \$6,200, then the taxpayer must pay \$6,200 to the U.S. Government (composed of \$5,300 of regular income taxes and \$900 of AMT). As is well known today, the

90. H.R. REP. NO. 91-782, at 210 (1969) (Conf. Rep.), *as reprinted in* 1969 U.S.C.C.A.N. 2391, 2490; S. REP. NO. 91-552, at 1, 13 (1969), *as reprinted in* 1969 U.S.C.C.A.N. 2027, 2039 (1969) (in 1966, 154 taxpayers had AGI in excess of \$200,000 and paid no income tax).

91. Many of these taxpayers reduced their taxable income by excluding one-half of their long-term capital gains from income and using their itemized deductions against any remaining income. S. REP. NO. 91-552, pt. 1, at 13, *as reprinted in* 1969 U.S.C.C.A.N. 2027, 2040.

The Senate Finance Committee wrote:

The fact that present law permits a small minority of high-income individuals to escape tax on a large proportion of their income has seriously undermined the belief of taxpayers that others are paying their fair share of the tax burden. It is essential that tax reform be obtained not only as a matter of justice but also as a matter of taxpayer morale. Our individual and corporate income taxes, which are the mainstays of our tax system, depend upon self-assessment and the cooperation of taxpayers. The loss of confidence on their part in the fairness of the tax system could result in a breakdown of taxpayer morale and make it far more difficult to collect the necessary revenues.

Id.

92. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 301(a), 83 Stat. 487, 580-86 (codified as I.R.C. § 56(a)).

93. See Robert P. Harvey & Jerry Tempalski, *The Individual AMT: Why It Matters*, 50 NAT'L TAX J. 453, 454 (1997).

94. I.R.C. §§ 55-59 (West 2006).

95. I.R.C. § 55(a).

computation under the AMT can be quite complex.⁹⁶

In computing a taxpayer's AMT liability, the starting point is the taxpayer's taxable income as computed for regular tax purposes.⁹⁷ A number of modifications are made to taxable income in arriving at alternative minimum taxable income ("AMTI").⁹⁸ These modifications usually increase taxable income, but in a few cases they decrease taxable income in arriving at AMTI. Some common examples of modifications include:

- (1) no deduction for miscellaneous itemized deductions;⁹⁹
- (2) deduction for medical expenses only to the extent they exceed ten percent of adjusted gross income;¹⁰⁰
- (3) no deduction for home equity indebtedness unless the proceeds are used to substantially improve the residence;¹⁰¹
- (4) no standard deduction and no deduction for personal exemptions;¹⁰²
- (5) no deduction for personal property, real property, and state and local income taxes;¹⁰³
- (6) inclusion in income of *certain* tax-exempt interest;¹⁰⁴
- (7) inclusion in income on stock exercised pursuant to incentive stock options;¹⁰⁵ and
- (8) 150 percent declining balance method of depreciation used for tangible personal property.¹⁰⁶

As a result of the modifications, the income base under the AMT is generally broader than the income base under the regular tax system.¹⁰⁷ It is also through these modifications that, in some cases, a provision providing a benefit under the regular income tax may give no benefit under the AMT.¹⁰⁸

96. See, e.g., 2 STAFF OF THE J. COMM. ON TAXATION, 107TH CONG., STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, II 13 (Comm. Print 2001) [hereinafter JCT SIMPLIFICATION STUDY]; PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 9-10; NATIONAL TAXPAYER ADVOCATE, 2004 ANNUAL REPORT TO CONGRESS 383-385 (2004) [hereinafter NTA 2004 REPORT]. Arguably, the reason for the complexity in the AMT is that the AMT calculation is coupled with the regular income tax calculation, which itself is far more complex than the AMT.

97. I.R.C. § 55(b)(2).

98. I.R.C. § 55(b)(2)(A), (B).

99. I.R.C. § 56(b)(1)(A)(i).

100. I.R.C. § 56(b)(1)(B).

101. I.R.C. § 56(b)(1)(C), (e).

102. I.R.C. § 56(b)(1)(E).

103. I.R.C. § 56(b)(1)(A)(ii).

104. I.R.C. § 57(a)(5).

105. I.R.C. § 56(b)(3).

106. I.R.C. § 56(a)(1).

107. Professor Michael Graetz has suggested repealing the regular tax and retaining the AMT thereby creating a broad-based (almost) flat rate tax system that many tax scholars find desirable. See, e.g., MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION* 773 (5th ed. 2005); Michael J. Graetz, *The 1982 Minimum Tax Amendments as a First Step in the Transition to a "Flat-Rate" Tax*, 56 S. CAL. L. REV. 527 (1983). But see PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 87 (rejecting the idea of eliminating the regular tax and retaining the AMT).

108. For example, tax-exempt interest is excluded from gross income for purposes of the regular income tax. I.R.C. § 103(a). However, as part of the 1986 Act, Congress pro-

Once the adjustments and preferences are made in arriving at AMTI, the exemption amount must be considered. The exemption amount is \$45,000 for married couples (\$58,000 for years 2003 through 2005) and \$33,750 for single taxpayers (\$40,250 for years 2003 through 2005).¹⁰⁹ The exemption amount is subtracted from AMTI in arriving at taxable excess.¹¹⁰ For example, if a married couple has taxable income of \$60,000 and adjustments and preferences of \$40,000, their AMTI would be \$100,000 (\$60,000 taxable income plus \$40,000 adjustments and preferences). In year 2004, the taxable excess for this couple would be \$42,000 (\$100,000 AMTI minus \$58,000 exemption amount). Once the taxable excess is determined, it is multiplied by the AMT rates, which are currently 26% and 28%.¹¹¹ The 26% rate applies to taxable excess up to \$175,000.¹¹² Any taxable excess above \$175,000 is taxed at 28%.¹¹³ As a result, the AMT is (ever so slightly) progressive.¹¹⁴ This couple would have an AMT liability of \$10,920 (\$42,000 taxable excess multiplied by 26% rate). The couple would pay the greater of their regular tax liability or their AMT liability. Assume, using the year 2004 tax rate tables, this couple has a \$5,900 regular income tax liability. Because their AMT liability is greater, they must pay \$10,920 in taxes to the U.S. Government (composed of \$5,900 in regular income taxes and \$5,020 in AMT).

For many years, the AMT affected only a very small percentage of taxpayers.¹¹⁵ However, the AMT contained a major flaw: the lack of index-

vided that interest on certain private activity bonds issued after August 7, 1986 will be treated as a preference item. I.R.C. § 57(a)(5)(c). This means that although the interest is excluded from gross income for regular income tax purposes, the interest is included in income for AMT purposes and therefore taxed under the AMT.

109. I.R.C. § 55(d)(1). The exemption amount is phased out for upper income taxpayers. I.R.C. § 55(d)(3). Generally, the exemption amount is reduced by an amount equal to 25% of the excess of AMTI over a set amount—\$150,000 for married filing jointly and \$112,500 for single taxpayers. *Id.* Because of the phase-out of the exemption amount, the marginal AMT tax rate is raised by 25% multiplied by the tax rate. In other words, if a taxpayer is in the phase-out range, the marginal AMT rates are 32.5% and 35%. Once the taxpayer has cleared the phase-out range, the marginal AMT rate again becomes 28 percent. See PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 87. This bubble effect partially explains why the very upper income taxpayers are generally not subject to the AMT. Under the regular income tax system, these very upper income taxpayers are subject to a marginal tax rate of 35% as compared to 28% under the AMT.

110. I.R.C. § 55(b)(1)(A)(ii).

111. I.R.C. § 55(b)(1)(A). Net capital gain is generally taxed at its regular tax rates so that the AMT accommodates the preferential rates for capital gains. I.R.C. § 55(b)(3). But a taxpayer in the AMT exemption phase-out range will be subject to an approximately 21.5% to 22% marginal tax rate on each additional dollar of net capital gain because net capital gain is included in alternative minimum taxable income. During the exemption phase-out range, the AMT rates are effectively increased by 6.5 to 7 percentage points. See *supra* note 109. As a result, an additional dollar of net capital gain for a taxpayer in the AMT exemption phase-out range is taxed 6.5 to 7 percentage points higher than the normal 15% net capital gain AMT rate. See Buckley, *supra* note 86, at 351, 352.

112. I.R.C. § 55(b)(1)(A)(i)(I).

113. I.R.C. § 55(b)(1)(A)(i)(II).

114. But see *supra* note 109.

115. See JCT SIMPLIFICATION STUDY, *supra* note 96, at 13. For example, in 1987, only 140,000 returns had AMT liability, which was approximately 0.1% of all filed returns; in 1998, only 853,000 returns had AMT liability, which was approximately 0.7% of all filed

ing for inflation of the AMT parameters.¹¹⁶ For example, under the regular income tax system, the standard deduction, personal exemptions, and tax rate brackets are all indexed for inflation each year.¹¹⁷ As a result, nominal dollar increases in income that merely keep pace with inflation do not push a taxpayer into higher tax rate brackets under the regular income tax. Under the AMT system, however, the exemption amounts and the tax rate brackets are not indexed for inflation. As a result, even prior to the 2001 Act, more taxpayers each year were becoming subject to the AMT purely as a result of normal, predictable inflation and the AMT's lack of a mechanism to account for it.¹¹⁸ In fact, in early 2000, Treasury estimated that 1.3 million taxpayers were currently subject to the AMT and that by the year 2010, 17 million taxpayers would be subject to the AMT if changes were not made to the existing AMT structure.¹¹⁹ Treasury noted that the AMT increasingly would apply to middle-income taxpayers, particularly those with children, due to the disallowance of all personal exemptions in computing the AMT.¹²⁰

Since 2001, it appears that the large tax cuts contained in the 2001 and 2003 Acts have greatly contributed to the increasing number of individuals subject to the AMT.¹²¹ In fact, the large tax cuts in 2001 and 2003

returns. *Id.* at 17. These figures do not include taxpayers whose regular income tax liabilities are affected by the AMT through personal tax credit limitations. *Id.*

116. See, e.g., PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 9 ("But the AMT has a significant flaw: Its definition of high income [exemption amount] was never indexed for inflation."); Harvey & Tempalski, *supra* note 93, at 453 ("The reason for the projected sharp increase in the number of AMT taxpayers is that the main parameters (that is, personal exemption, standard deduction, and tax-bracket widths) of the regular tax are indexed for inflation, whereas the main parameters of the AMT are not."). See generally Robert Rebelein & Jerry Tempalski, *Who Pays the Individual AMT?*, O.T.A. PAPER 87 (2000), reprinted in TAX NOTES TODAY, July 13, 2000, LEXIS, 2000 TNT 135-33.

117. I.R.C. §§ 63(c)(4), 151(d)(4), 1(f).

118. See, e.g., JCT SIMPLIFICATION STUDY, *supra* note 96, at 14 ("Thus, inflation can cause individuals to be alternative minimum taxpayers."); GRAETZ & SCHENK, *supra* note 107, at 770; Harvey & Tempalski, *supra* note 93, at 453.

119. U.S. Treasury Dep't, *Treasury Release on White House AMT Proposal*, TAX NOTES TODAY, Jan. 21, 2000, LEXIS, 2000 TNT 14-47.

120. *Id.* The AMT also created disparate treatment of taxpayers depending on where they lived. Taxpayers who lived in states with high state income taxes were more likely to be subject to the AMT than taxpayers living in states with low or no state income taxes. JCT SIMPLIFICATION STUDY, *supra* note 96, at 14. This was due to the disallowance of all state and local income taxes in computing the AMT. See I.R.C. § 56(b)(1)(A)(ii).

121. See, e.g., Michael Parisi & Scott Hollenbeck, *Individual Income Tax Returns 2003*, 25 STAT. INCOME BULL. 9 (2005). For tax year 2003, "the alternative minimum tax (AMT) increased 38.2 percent, with 23.4-percent more taxpayers paying the AMT. Much of this increase is attributable to the tax rates on ordinary income being lowered while AMT rates remained unchanged (AMT is part of total income tax)." *Id.*

For the second year in a row, the alternative minimum tax increased. For 2003, the increase was \$2.6 billion, or 38.2 percent, to almost \$9.5 billion. The increase in AMT occurred even though the AMT exemption amount was raised as part of JGTRRA [Jobs Growth and Tax Relief Reconciliation Act of 2003] This is largely attributable to the decrease in ordinary income tax rates due to JGTRRA, while the tax rates on alternative minimum taxable income remained the same as 2002. Over 0.4 million more taxpayers were required to pay the AMT for 2003.

Id.

may possibly be the primary reason for the projected explosion in the number of individuals expected to be snared by the AMT.¹²² The Treasury Department has estimated that approximately 21.6 million taxpayers will be affected by the AMT in 2006 (assuming the increased exemption amounts expire in 2005 as they are scheduled to do), and by 2015, 52 million taxpayers will be affected by the AMT.¹²³ The bottom line is that as a result of the lack of indexing of the AMT parameters for inflation, coupled with the tax cuts contained in the 2001 and 2003 Acts, more taxpayers each year are becoming subject to the AMT. What was once thought to be a minor problem affecting a relatively small percentage of taxpayers has now escalated into probably the single biggest problem in the current income tax system, affecting millions of taxpayers.¹²⁴ Consequently, if Congress enacts a tax benefit under the regular income tax but does not provide that benefit under the AMT, a significant number of taxpayers may not receive either part or all of the benefit. The flip side is that the revenue cost of the tax benefit may be significantly less if the benefit is only provided for purposes of the regular income tax and not for purposes of the AMT. Lowering the revenue cost of a tax provision is, of course, extremely important today, considering the huge budget deficits that the United States is incurring each year.

After a large decline in AMT for 2001, partially resulting from a statutory increase in the AMT exemption, there was virtually no change in AMT for 2002. For 2003, despite the fact that there was another increase in AMT exemption amounts; AMT increased by 38.2 percent. This was most likely due to the tax rates on ordinary income being lowered, while AMT rates remained unchanged.

Id. at 19-21. See also Heather Bennett, *EGTRRA Will Subject "Startling" Number of Taxpayers to AMT By 2010*, 93 TAX NOTES 1150, 1150 (2001) (reporting on statistics presented by Jerry Tempalski, an economist with Treasury's Office of Tax Analysis, on the impact of the 2001 Act on the AMT); John Buckley, *AMT Explosion: Bush Cuts Still to Blame*, 108 TAX NOTES 1581, 1581 (2005) (memo from George K. Yin, Chief of Staff, Joint Committee on Taxation, to John Buckley discussing effect of 2001 and 2003 Acts on AMT).

122. See Buckley, *supra* note 86, at 348 (tax cuts since 1996 are the primary cause for the projected explosion of the AMT). But see Prater & Mistr, *supra* note 86, at 699 (lack of indexing of the AMT parameters is the primary cause of the projected explosion of the AMT). See also John Buckley, *AMT Explosion Causation: A Surrebuttal*, 108 TAX NOTES 958, 958 (2005); Buckley, *supra* note 121, at 1581; Mark Prater & Christy Mistr, *AMT Explosion: Effect of Bush Tax Cuts Overstated*, 109 TAX NOTES 545, 545 (2005); Heidi Glenn, *JCT Numbers Show Tax Cuts' Effect on AMT*, 109 TAX NOTES 14, 14 (2005) (based on JCT numbers, Buckley continues to argue that the Bush tax cuts are the primary cause of the AMT problem and Prater continues to argue that the lack of indexing of the inflation parameters is the leading cause).

123. PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 10. The Joint Committee on Taxation has estimated that the number of taxpayers subject to the AMT will be about 19 million in 2006 and about 29 million in 2010. See STAFF OF THE J. COMM. ON TAXATION, 109TH CONG., PRESENT LAW AND BACKGROUND RELATING TO THE INDIVIDUAL ALTERNATIVE MINIMUM TAX 11 (Comm. Print 2005).

124. See, e.g., PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at chs. 4-5 (starting point for tax reform generally begins with repealing the AMT); JCT SIMPLIFICATION STUDY, *supra* note 96, vol. 1, at 10 & vol. 2, at 2-22 (first simplification recommendation was to repeal the AMT); NTA 2004 REPORT, *supra* note 96, at 3 (in 2003, the individual AMT was identified as the most serious problem facing taxpayers and in 2004 it is again recognized as a serious problem that needs to be repealed or substantially revamped).

As previously stated, the 1996 presidential campaign of former Senator Robert Dole has been credited by one Democratic congressional aide with establishing the idea of a large tax cut plan in which a major portion of the tax cuts never materialize because of the AMT.¹²⁵ The Dole campaign proposed a fifteen percent across the board reduction in individual income tax rates.¹²⁶ However, the Dole campaign made no mention of reducing AMT rates.¹²⁷ By reducing regular income tax rates but leaving AMT rates intact, more taxpayers would become subject to the AMT, and those taxpayers already subject to the AMT would receive no current benefit from a reduction in regular income tax rates. To illustrate this principle using a very simple example focusing solely on rates, assume a taxpayer has \$1,000 of income and is subject to a regular tax rate of 28 percent. Assume that the AMT rate is 26%. Therefore, the taxpayer has a tax liability of \$280, the greater of the regular tax liability (28% of \$1,000) or the AMT liability (26% of \$1,000). If the regular tax rate is cut to 25% (and ignoring the AMT), then the taxpayer will have a tax savings of \$30 (\$280 minus \$250). However, if the AMT is taken into account and the AMT rate remains at 26%, then the taxpayer becomes an AMT taxpayer and has a total tax liability of \$260 (\$250 regular tax liability and \$10 of AMT liability). The tax cut only provided \$20 in tax savings, not \$30. The AMT "recaptured" \$10 of the potential tax savings.¹²⁸

The Dole campaign also proposed a \$500 tax credit for every child eighteen years of age or younger to low and middle income families.¹²⁹ Apparently, the proposed child credit would not be creditable for AMT purposes.¹³⁰ Even though Senator Dole lost the presidential election in 1996 to President Bill Clinton, Congress, in 1997, enacted a child credit for low and middle income families. The credit applied to every child

125. See Buckley, *supra* note 86, at 349. See also Al Davis, *Candidate Bush's Tax Cut Plan*, 86 TAX NOTES 271, 272 (2000) ("The 1996 Dole campaign made its [fifteen] percent across-the-board rate cut look much more likely to fit with a federal budget by letting the alternative minimum tax (AMT) kick in and short-circuit the 'cuts' in the regular income tax."); Sullivan, *supra* note 87, at 1467.

126. See Bob Dole, *Restoring The American Dream: Bob Dole's Plan for Economic Growth*, TAX NOTES TODAY, Aug. 6, 1996, at para. 21, LEXIS, 96 TNT 153-17 [hereinafter *Dole Tax Plan*] (the reduction would occur in three steps starting in 1997).

127. See J. Comm. on Taxation, *JCT Issues Memo on Individual AMT Under Dole Tax Proposal*, TAX NOTES TODAY, Sept. 13, 1996, at para. 2, LEXIS, 96 TNT 180-29 ("It is our understanding [staff of the Joint Committee on Taxation] that under the [Dole] proposal the individual AMT would remain as under present law. There would be no change in rates, brackets or exemptions."). See also *id.* para. 9 (memo from the Democratic staff of the Ways and Means Committee) ("The fact that the [alternative] minimum tax rates were not reduced in the Dole proposal was probably deliberate. It reduced the revenue cost of the proposal dramatically and, improved its distribution.").

128. Taxpayers are permitted minimum tax credits, which are generally equal to the AMT liability, with some adjustments. I.R.C. § 53 (West 2006). As a result, a taxpayer subject to the AMT may credit the AMT liability against the regular tax liability in later years. I.R.C. § 53(a). However, the minimum tax credit may not be used to reduce AMT liability in later years. I.R.C. § 53(c). Therefore, a taxpayer consistently subject to the AMT in later years will receive no benefit from the minimum tax credit and the value of the credit will diminish as time passes. See LATHROPE, *supra* note 89, ¶ 10.02[1][b].

129. See *Dole Tax Plan*, *supra* note 126, para. 21.

130. See *supra* note 127.

under the age of seventeen years with the amount set at \$400 per child for 1998, increasing to \$500 per child in 1999 and thereafter.¹³¹

When Congress enacted the child tax credit in 1997 (effective beginning in 1998, along with other nonrefundable credits such as the two educational credits—the Hope credit and the lifetime learning credit), it retained the limitation on the use of nonrefundable credits, which was equal to the excess of the individual's regular tax liability over the individual's tentative minimum tax.¹³² To illustrate the limitation, assume an individual has a regular income tax liability of \$15,000 and a tentative minimum tax of \$14,700. The individual has one small child, entitling the individual to a child credit of \$400 in 1998. Under the limitation, only \$300 of the credit is available to the individual (the excess of \$15,000 over \$14,700) and therefore \$100 of the credit is lost.

As a result of the limitation, many taxpayers would not receive the full tax benefit associated with the child credit (and the education credits) because of the AMT, thereby lowering the cost of the legislation. However, the very next year, in 1998, when the child credit and education credits became effective, Congress enacted a provision permitting full use of the nonrefundable credits against the regular income tax but only for taxable years beginning in 1998.¹³³ The following year, as part of the Tax Relief Extension Act of 1999, Congress extended full use of the nonrefundable credits against the regular income tax for one additional year, and provided that for taxable years beginning in 2000 and 2001, nonrefundable credits were fully creditable against both the regular income tax and the AMT.¹³⁴ Congress has since extended an individual's use of nonrefundable credits against both the regular income tax and the AMT through 2005.¹³⁵ For years after 2005, only three nonrefundable credits (including the child credit but not the education credits) are fully creditable against both the regular income tax and the AMT.¹³⁶

131. The 2001 Act increased the child tax credit from \$500 to \$1,000 but phased-in over ten years (\$600 in 2001 through 2004, \$700 in 2005 through 2008, \$800 in 2009, and \$1,000 in 2010). Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 201(a), 115 Stat. 38, 45 (codified as amended at I.R.C. § 24). The 2003 Act increased the child credit from \$600 to \$1,000 for 2003 and 2004. Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, § 101(a), 117 Stat. 753, 753 (codified as amended at I.R.C. § 24). The Working Families Tax Relief Act of 2004 set the credit at \$1,000. Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, § 101(a), 118 Stat. 1166, 1167 (codified as amended at I.R.C. § 24).

132. I.R.C. § 26(a).

133. Tax and Trade Relief Extension Act of 1999, Pub. L. No. 105-277, § 2001(a), 112 Stat. 2681, 2681-901 (1999) (codified at I.R.C. § 26).

134. Tax Relief Extension Act of 1999, Pub. L. No. 106-170, § 501, 113 Stat. 1860, 1918 (codified as amended at I.R.C. § 26).

135. Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, § 601(a), 116 Stat. 21, 59 (codified as amended at I.R.C. § 26) (extending full use of nonrefundable credits for taxable years beginning in 2002 and 2003); Working Families Tax Relief Act of 2004 § 312(a), 118 Stat. at 1181 (codified as amended at I.R.C. § 26) (extending full use of nonrefundable credits for taxable years beginning in 2004 and 2005).

136. I.R.C. § 26(a)(1). For years after 2005, the other nonrefundable credits (such as the education credits) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax.

Four years after Senator Dole's unsuccessful run for the presidency, the 2000 presidential campaign of then Governor George W. Bush proposed a large tax cut plan that included a reduction in the top income tax rates and an increase in the child tax credit from \$500 to \$1,000.¹³⁷ The plan, as originally released on December 1, 1999, made no mention of the AMT, prompting a Democratic congressional aide to compare the Bush tax plan to the Dole tax plan and suggest that history may be repeating itself.¹³⁸ About a month and a half after its release, the Bush campaign amended its tax plan, inserting parenthetical language and a new paragraph to explain that the proposed \$1,000 child tax credit was also creditable for AMT purposes.¹³⁹ The Bush plan did not propose a reduction in the AMT tax rates despite the proposed reduction in the regular income tax rates.¹⁴⁰ As a result, many taxpayers already subject to the AMT would receive very little or no current tax benefit under the Bush tax plan and many other taxpayers would become subject to the AMT.¹⁴¹ In fact, the Joint Committee on Taxation estimated that 26.9 million taxpayers would become subject to the AMT by the year 2010 if the Bush tax plan were enacted into law.¹⁴² Although the AMT problem was identified rather quickly after Bush proposed his tax plan,¹⁴³ it did not become much of an

137. See George W. Bush, *Summary of George W. Bush's Tax Cut Plan*, TAX NOTES TODAY, Dec. 2, 1999, at para. 2, LEXIS, 1999 TNT 231-29.

138. See Davis, *supra* note 125, at 272 ("The 1996 Dole campaign made its 15 percent across-the-board rate cut look much more likely to fit with a federal budget by letting the alternative minimum tax (AMT) kick in and short-circuit the 'cuts' in the regular income tax. History may be repeating itself [with the Bush campaign].").

139. See George W. Bush, *AMT Insert into Bush Tax Plan*, TAX NOTES TODAY, Jan. 14, 2000, at para. 50, LEXIS, 2000 TNT 10-42 [hereinafter *Bush Tax Plan II*] (the new paragraph read: "The current \$500 child credit is beginning to throw middle-income families onto the Alternative Minimum Tax. Governor Bush's tax plan would apply the full value of the new \$1,000 child credit to the AMT. As a result, no taxpayer would be forced to pay the AMT tax because of the child credit.").

When Governor Bush originally proposed his tax plan on December 1, 1999, the \$500 child tax credit in existing law was not fully creditable against both the regular income tax and the AMT. I.R.C. § 26(a) (Supp. IV 1998). Two and a half weeks later, on December 17, 1999, with the enactment of the Tax Relief Extension Act of 1999, Congress permitted the \$500 child tax credit to be fully creditable (along with other nonrefundable credits) against both the regular income tax and the AMT (for years 2000 and 2001). As a result, when the Bush campaign amended their tax plan in mid-January 2000 to specifically state that their proposed \$1,000 child tax credit was fully creditable against the AMT, it became merely a restatement of existing tax law with respect to the AMT.

140. The Bush tax plan provided for five tax rates: 10%, 15%, 25%, 28%, and 33%. See *Bush Tax Plan II*, *supra* note 139, para. 2. As a result, the top rate would be reduced from 39.6% to 33%. See also Lawrence B. Lindsey, *Governor Bush's Proposal and the Alternative Minimum Tax*, 86 TAX NOTES 553, 354 (2000) (the Bush tax plan provided AMT relief for the proposed \$1,000 child tax credit because it was a higher priority with respect to middle-income taxpayers than reducing AMT rates).

141. See Lindy L. Paull, *Paull Response to Rangel on AMT and Bush Tax Plan*, TAX NOTES TODAY, Oct. 3, 2000, at para. 13, LEXIS, 2000 TNT 192-14.

142. *Id.* See also Charles B. Rangel, *Rangel Release on JCT Study on Bush Tax Plan*, 2000 TAX NOTES TODAY, Oct. 2, 2000, LEXIS, 2000 TNT 192-16; Warren Rojas, *JCT Estimates Bush Tax Cut Would Double AMT Taxpayers*, 89 TAX NOTES 171, 171 (2000).

143. See, e.g., Davis, *supra* note 125; PAUL KRUGMAN, FUZZY MATH 96-97 (2001) ("Ever since Bush proposed his tax cut during the campaign, tax analysts have warned that

issue during the 2000 presidential campaign.¹⁴⁴

Overlooking the AMT, whether or not intentional, appears to be a common problem in presidential campaigns. For example, the 2000 presidential campaign of Vice-President Al Gore overlooked the AMT in its 192-page tax plan.¹⁴⁵ This may have been one of the reasons why the AMT was not much of an issue during the 2000 presidential campaign: both the Bush and Gore campaigns appear to have ignored (or overlooked) the AMT.¹⁴⁶ It is unlikely, however, that this will happen again in 2008, assuming the AMT is still in existence.¹⁴⁷ Until that time, Congress will likely continue to enact provisions intended to benefit taxpayers yet make the benefit unavailable under the AMT, just as it did last year with the three new energy credits in the Energy Tax Incentives Act of 2005.¹⁴⁸ Congress's intent appears to be to lower the revenue cost of the provisions, which is extremely important with the budget deficits the United States continues to incur each year.

B. INCOME TAX VERSUS A CONSUMPTION TAX

For many years, tax scholars have debated the merits of an income tax system versus a consumption tax system.¹⁴⁹ A number of books and articles have been written discussing the advantages of one tax system versus the other.¹⁵⁰ The U.S. tax system is primarily an income tax system with

there was a lurking problem—a land mine in the road—involving the alternative minimum tax.”).

144. There was a brief debate in *Tax Notes* magazine between the late Al Davis, chief Democratic economist for the House Ways and Means Committee, and Lawrence Lindsey, chief economic advisor to then Governor Bush and architect of the Bush tax plan. See, e.g., Davis, *supra* note 125; Lindsey, *supra* note 140; Al Davis, *Further Thoughts on the Bush Tax Cut Plan*, 86 *TAX NOTES* 857 (2000).

145. See Al Gore & Joseph I. Lieberman, *Gore/Lieberman Economic Plan*, “Prosperity for America’s Families,” *TAX NOTES TODAY*, Sept. 11, 2000, LEXIS, 2000 TNT 176-70.

146. One of the reasons why both the Bush and Gore campaigns did not focus on the AMT may have been that, in 2000, a very small percentage of taxpayers were subject to the AMT. See *supra* notes 115-20 and accompanying text. It had not yet escalated into the problem the AMT is today.

147. A number of organizations have called for repeal of the individual AMT. See, e.g., JCT SIMPLIFICATION STUDY, *supra* note 96, vol. 1, at 10 & vol. 2, at 2-22 (recommending repeal of both the individual and corporate AMT); PRESIDENT’S TAX ADVISORY PANEL REPORT, *supra* note 3, chs. 4-5 (recommending repeal of both the individual and corporate AMT); NTA 2004 REPORT, *supra* note 96, at 3, 383-85 (recommending repeal or substantial revamping).

148. The Energy Tax Incentives Act of 2005 introduced the nonbusiness energy property credit (code section 25C), residential energy efficient property credit (code section 25D), and the alternative motor vehicles credit (code section 30B). Energy Tax Incentives Act of 2005, Pub. L. No. 109-58 §§ 1333, 1335, 1341, 119 Stat. 594, 1026-1049 (2005). Each of these credits is nonrefundable and not creditable for AMT purposes. I.R.C. §§ 26(a)(1) & 30B(g)(2) (West 2002 & Supp. 2005).

149. Works by Nicholas Kaldor and Bill Andrews have generally been credited with reviving interest in a consumption tax system. See NICHOLAS KALDOR, *AN EXPENDITURE TAX* (1955); William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 *HARV. L. REV.* 1113 (1974).

150. For older but often cited articles in the consumption tax versus income tax debate, see, e.g., Andrews, *supra* note 149; William D. Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 *HARV. L. REV.* 947 (1975); Michael J. Graetz, *Imple-*

elements of a consumption tax system.¹⁵¹ As a result, the U.S. system would be most accurately described as a hybrid tax system with elements of both income and consumption taxes.¹⁵²

The Bush Administration, from at least midway through its first term, was thought to favor a consumption tax system over an income tax system.¹⁵³ In addition, many members of Congress also favor a consumption tax system.¹⁵⁴ However, it may be extremely difficult for the United

menting a Progressive Consumption Tax, 92 HARV. L. REV. 1575 (1979); Alvin C. Warren, *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 HARV. L. REV. 931 (1975); Alvin C. Warren, *Would a Consumption Tax Be Fairer than an Income Tax?*, 89 YALE L.J. 1081 (1980).

The debate between a consumption tax and an income tax has, in more recent times, focused on the taxation of risk. More specifically, an income tax taxes the risk-free rate of return on capital while a consumption tax does not. However, under certain assumptions, neither an income tax nor a consumption tax taxes the risk premium. See, e.g., Noel B. Cunningham, *The Taxation of Capital Income and the Choice of Tax Base*, 52 TAX. L. REV. 17 (1996); Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax Is Exempt Under a Cash Flow Tax?*, 52 TAX. L. REV. 1 (1996); David A. Weisbach, *The (Non)Taxation of Risk*, 58 TAX. L. REV. 1 (2004).

151. See, e.g., BITTKER & LOKKEN, *supra* note 62, ¶ 3.7, at 3-81 ("Although theorists think of income and consumption taxes as opposites, Congress has not, and over the years, it has introduced many elements of an annual consumption tax into the tax we know as the federal income tax."); UNEASY COMPROMISE: PROBLEMS OF A HYBRID INCOME-CONSUMPTION TAX (HENRY J. AARON et al. eds., 1988).

See also PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 21-22 (approximately 36% of the proceeds from household savings are effectively exempt from taxation).

152. See GRAETZ & SCHENK, *supra* note 107, at 40 ("Our current federal 'income' tax, in fact, has become a 'hybrid' that is part wage or consumption tax and part income tax.").

153. See, e.g., Bruce Bartlett, *Bush's High Five*, NAT'L REV. ONLINE, Feb. 10, 2003, http://www.nationalreview.com/nrof_bartlett/bartlett021003.asp ("By Bush's second term, it is possible that we will have made enough incremental progress toward a flat rate consumption tax that we may finally see fundamental tax reform fully enacted into law. If so, it will be testament to a very clever, yet bold strategy that was initially invisible even to people like me, who study such things for a living. I am impressed."); Daniel Altman, *Accounts Chock-Full, Or a Plan Half Empty?* N.Y. TIMES, Feb. 1, 2003, at C1; Edmund L. Andrews, *Taking Steps Toward Goal of No Tax for Investors*, N.Y. TIMES, Feb. 6, 2003, at C1; Greg Ip, *Bush Floats Shift to Consumption Tax*, WALL ST. J., Feb. 10, 2003, at A3; Grover Norquist, *Step-By-Step Tax Reform*, WASH. POST, June 9, 2003, at A21; Review & Outlook, *Bush's Tax Reform*, WALL ST. J., Feb. 5, 2003, at A18. See also ECONOMIC REPORT OF THE PRESIDENT (Feb. 2003), ch. 5. But see Edmund L. Andrews, *Bush Economic Advisor Says He's Not Finished Yet*, N.Y. TIMES, Jan. 24, 2003, at C5 ("In a meeting with reporters last week, Mr. [Glenn] Hubbard [chair of the Council of Economic Advisors] insisted that Mr. BUSH's current plan was separate from that more distant goal [tax overhaul leading to a flat tax or broad-based consumption tax]. 'The president is a pretty straight shooter,' Mr. Hubbard said. 'If he had wanted fundamental TAX reform, he would have said so.'").

Some Bush Administration officials have been quite open on their views for a consumption based tax system. See, e.g., Andrews, *supra*, at C5 ("[Glenn] Hubbard [chair of the Council of Economic Advisors] has long viewed the elimination of dividend TAXES as merely the first step toward a broader overhaul of the TAX system—an overhaul that might eventually lead to a flat TAX or a broad-based consumption tax."); Dustin Stamper, *White House Advisor Touts Benefits of Consumption Tax*, 106 TAX NOTES 1489 (2005) (quoting Council of Economic Advisors member Kristin J. Forbes); Alison Bennett, *Ideal Economic Scenario Would be Zero Rate on Investment Income, Treasury Official Says*, BNA DAILY TAX REP. Nov. 18, 2005, at G-1 (quoting Deputy Assistant Secretary for Tax Analysis Robert Carroll).

154. See, e.g., Fair Tax Act of 2005, H.R. Res. 25, 109th Cong. (2005), introduced on January 4, 2005 by Rep. John Linder, R-GA, with forty-three co-sponsors, which would

States to openly shift from taxing income to taxing consumption. The public may view such a shift as primarily benefiting wealthy taxpayers at the expense of middle income and lower income taxpayers.¹⁵⁵ As a result, one way of shifting from an income tax system to a consumption tax system is to do it openly but in an incremental and subtle manner over a period of time.

The magnitude of such a shift in the tax system in full view of taxpayers would be comparable, in the magic world, to Harry Houdini, in 1918, vanishing a 6,000 pound elephant in a giant circus wagon in front of 5,200 people at the New York Hippodrome, or David Copperfield, in 1983, vanishing the Statue of Liberty in front of a both a live and television audience. Both Houdini and Copperfield probably utilized fakes in accomplishing their tricks—in Houdini's case a fake giant circus wagon to hide the elephant, and in Copperfield's case a fake platform for viewing the statue vanish.¹⁵⁶ It appears that openly but subtly shifting the tax system from income-based to consumption-based would fall within the magical categorization of a fake (or possibly a subtlety).¹⁵⁷ In other words, the tax changes are open and visible but not understood by taxpayers and many tax advisors.

To understand how to openly but incrementally shift the U.S. tax system from an income-based tax system to a consumption-based (or wage-based) tax system, it is important to have a thorough understanding of income and consumption (or wage) taxes. First, there are many types of consumption tax systems. Probably the most easily identified is the retail sales tax utilized by many states and localities.¹⁵⁸ Another familiar example is the value-added tax ("VAT") utilized by almost all of the industrialized countries of the world, with the United States being the main

replace all federal taxes with a 23% tax inclusive retail sales tax; Fair Tax Act of 2005, S. Res. 25, 109th Cong. (2005) (introduced on January 4, 2005 by Sen. Saxby Chambliss, R-GA, with one co-sponsor).

155. See, e.g., BRUCE BARTLETT, IMPOSTOR: HOW GEORGE W. BUSH BANKRUPTED AMERICA AND BETRAYED THE REAGAN LEGACY 179-80 (2006). One often-cited case of a leading politician advocating a consumption tax and then losing his re-election bid is that of U.S. Congressman Al Ullman. Ullman, a Democrat from Oregon, was chair of the House Ways and Means Committee in 1979 when he proposed a ten percent value-added tax ("VAT") for the United States. The next year, Ullman lost his bid for re-election to the U.S. House of Representatives after serving twenty-four years in Congress, thereby becoming the first chairman of the House Ways and Means Committee to be defeated for re-election. Some people claim that Ullman's proposal for a VAT caused him to lose re-election in 1980. See MICHAEL J. GRAETZ, THE U.S. INCOME TAX: WHAT IT IS, HOW IT GOT THAT WAY, AND WHERE WE GO FROM HERE 112, 196 (1999).

156. As to Houdini vanishing the elephant, see STEINMEYER, *supra* note 33. As to Copperfield vanishing the Statue of Liberty, see WILLIAM POUNDSTONE, BIGGER SECRETS 209-216 (1986).

157. See *supra* note 4 for a definition of subtlety, which is very similar to the definition of a fake.

158. Approximately forty-five states and the District of Columbia impose a retail sales tax. See Federation of Tax Administrators State Sales Tax Rate, <http://www.taxadmin.org/fta/rate/sales.html> (last visited Jan. 26, 2006).

exception.¹⁵⁹ The retail sales tax and VAT are easily identified as consumption taxes because they are paid at the time of consumption, that is, when the goods or services are purchased by the consumer from the vendor.¹⁶⁰

Although a retail sales tax or value-added tax appears to be completely different than an income tax, the primary difference between an income tax and a consumption tax is the tax treatment of income from capital.¹⁶¹ In order to illustrate this difference, it is important to understand exactly what "income" is. The Haig-Simons definition of income is generally considered by most tax scholars to be the ideal definition of income.¹⁶² This definition is the accretion concept of income, which defines income as the sum of consumption and accumulation.¹⁶³ Robert Haig published his definition of income in 1921, writing that income is

the increase or accretion in one's power to satisfy his wants in a given period in so far as that power consists of (a) money itself, or, (b) anything susceptible of valuation in terms of money. More simply stated, the definition of income which the economist offers is this: Income is the *money value of the net accretion to one's economic power between two points of time*.¹⁶⁴

159. Of the thirty member countries of the Organization for Economic Co-operation and Development ("OECD"), the United States is the only one that does not have a VAT. More than 135 countries use a VAT to raise some portion of their national government tax revenues. See PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 38.

160. The primary difference between a retail sales tax and a VAT is the timing of the collection of the tax. A VAT is typically collected at each stage of the production process. For example, a VAT would be collected as goods and services move from suppliers to manufacturers, wholesalers, and finally retailers. In contrast, a retail sales tax is collected only at the retail level. See GRAETZ & SCHENK, *supra* note 107, at 38-39.

161. See, e.g., Weisbach, *supra* note 150, at 1 ("The singular feature of an income tax is that it imposes a tax on capital income. It is this feature that distinguishes an income tax from a wage or consumption tax."); HENRY J. AARON ET AL., UNEASY COMPROMISE: PROBLEMS OF A HYBRID INCOME-CONSUMPTION TAX 1 (1988) ("The essential difference [between an income tax and a consumption tax] is that a consumption tax exempts savings, while an income tax does not."); Cunningham, *supra* note 150, at 43 ("The principal difference between a normative income tax and a normative consumption tax is that the income tax imposes a burden on capital income—and therefore wealth—and the consumption tax does not."); PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, at 207 ("Like other consumption taxes, the retail sales tax does not tax normal returns to savings and investment . . .").

162. See, e.g., BITTKER & LOKKEN, *supra* note 62, ¶ 3.1.1, at 3-94 ("Among contemporary American economists, the so-called Haig-Simons definition of 'income' is the most widely accepted . . ."); PAUL R. MCDANIEL ET AL., FEDERAL INCOME TAXATION 7 (5th ed. 2004) ("The income definition that has received the most support from American tax specialists is usually called the Haig-Simons concept but more accurately and less parochially could be named the Schanz-Haig-Simons (S-H-S) concept or definition."); GRAETZ & SCHENK, *supra* note 107, at 90 ("The Simons definition, which is considered a refinement of the Haig definition, is the most widely accepted and is usually referred to as the Haig-Simons definition of income.").

It is sometimes referred to as the Schanz-Haig-Simons definition of income, reflecting the early contribution of Georg von Schanz. See Georg von Schanz, Der Einkommenbegriff und die Einkommensteuergesetze, Finanz-Archiv, vol. 13, no. 1, at 23 (1896).

163. Robert M. Haig, *The Concept of Income—Economic and Legal Aspects*, in THE FEDERAL INCOME TAX 1 (Robert M. Haig ed., 1921).

164. *Id.* at 7.

Haig focused on the point in time when the power to satisfy one's wants is increased, not necessarily the point in time when the wants are actually satisfied.¹⁶⁵ As a result, Haig included savings in income even though it had not yet been consumed.

Henry Simons published his definition of income in 1938.¹⁶⁶ Simon's definition is considered a refinement of Haig's definition, and it is Simon's definition that is often cited today. Simons wrote that income is the "algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and the end of the period in question."¹⁶⁷ Simons also noted that, "in other words, [income] is merely the result obtained by adding consumption during the period to 'wealth' at the end of the period and then subtracting 'wealth' at the beginning."¹⁶⁸

To briefly illustrate the Haig-Simons definition of income, assume an individual earns a salary of \$100,000. Under the U.S. tax system, the salary is gross income and therefore the individual must pay taxes on it.¹⁶⁹ Under the Haig-Simons definition of income, however, the focus is on the use of the funds. Assume the individual spent \$40,000 on consumption (i.e., rent, food, vacation, etc.) and placed the remaining \$60,000 in a savings account. Under the Haig-Simons definition, the individual would have \$100,000 of income—\$40,000 of consumption plus \$60,000 net change in the value of the assets. Whether under the U.S. definition of income or the Haig-Simons definition, the individual would have \$100,000 of income.¹⁷⁰

As previously stated, one way of taxing consumption is for a country to adopt a retail sales tax or a VAT. But another method of taxing consumption is to utilize the Haig-Simons definition of income in determining the consumption base. The Haig-Simons definition of income, which defines income as the sum of consumption plus the net change in savings, can be expressed as a formula: $I \text{ (Income)} = C \text{ (Consumption)} + \Delta S \text{ (net change in Savings)}$. By isolating consumption (C), the formula can be arranged as $C \text{ (Consumption)} = I \text{ (Income)} - \Delta S \text{ (net change in Savings)}$. As a result, consumption can be taxed by first determining an individual's income and then subtracting any amount placed in savings. For example,

165. See STANLEY S. SURREY ET AL., *FEDERAL INCOME TAXATION* 61 (1986).

166. See HENRY C. SIMONS, *PERSONAL INCOME TAXATION* (1938).

167. *Id.* at 50.

168. *Id.*

169. I.R.C. § 61(a)(1) (West 2002). In the Internal Revenue Code, "gross income" is defined with reference to "income." "Income," however, is not defined in the Internal Revenue Code. See *id.* The Supreme Court has written, in holding that punitive damages are gross income, "Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955).

170. Significant departures of the current U.S. income tax system from a pure income tax system include the realization doctrine in the U.S. system, lack of indexing of assets and debt for inflation, limitations on deductibility of losses, non-taxation of rental value from owner-occupied homes and other assets, and non-taxation of the value of goods and services created by the taxpayer's own efforts.

if for the current year an individual had income of \$100,000 and placed \$60,000 in savings, then consumption would equal \$40,000. Under a consumption tax, only \$40,000 would be taxed in the current year. When the amount in savings is removed in some future year and consumed, it will be taxed in that future year, i.e., the time of consumption.

The United States has elements of a consumption tax system even though most taxpayers refer to the U.S. system as an income tax system. For example, individuals are permitted to place money into one of many different kinds of qualified retirement plans.¹⁷¹ In many of these plans, the tax laws permit the individual to either exclude from gross income or deduct the amounts placed into the plans.¹⁷² The funds grow tax-free as long as they are held in the plan. When the amounts are removed from the retirement plan, the individual must include it in gross income at that time and pay taxes on it.¹⁷³ As a result, the United States is, in essence, taxing consumption and not income with respect to amounts placed in qualified retirement plans.

A wage tax (sometimes referred to as a prepaid consumption tax) is, under certain assumptions, equivalent to a (postpaid) consumption tax.¹⁷⁴ More specifically, a tax solely on service income, such as wages or salaries, may yield equivalent results to a tax on consumption.¹⁷⁵ Under a wage tax, income on capital would not be taxed. Therefore, items such as

171. See generally I.R.C. §§ 401-409 (West 2002 & Supp. 2005).

172. For example, two of the most popular retirement plans are 401(k) plans and traditional IRAs. Under a 401(k) plan, the amounts that an employer deducts from an employee's salary and contributes into the plan for the benefit of the employee is referred to as an elective deferral and is not currently taxed to the employee. More specifically, the elective deferral is excluded from the employee's gross income. I.R.C. § 402(g). In a traditional IRA, however, the amount an individual contributes into the retirement plan is deducted from the individual's gross income for the year as an above-the-line deduction. I.R.C. §§ 219 & 62(a)(7).

173. I.R.C. §§ 402(a) & 408(d).

174. See E. Cary Brown, *Business Income Taxation and Investment Incentives*, in *INCOME, EMPLOYMENT AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSEN* 300, 309-10 (1948), reprinted in *AMERICAN ECONOMICS ASSN., READINGS IN THE ECONOMICS OF TAXATION* 525-537 (Richard A. Musgrave & Carl S. Shoup eds., 1959). Dr. Brown has been credited with developing the theorem that immediately deducting the cost of an asset is equivalent to excluding the return of the asset from tax. From this theorem, others have proposed the theory that under certain assumptions, a wage tax (prepaid consumption tax) is equivalent to a (postpaid) consumption tax. See, e.g., Alvin C. Warren, Jr., *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 HARV. L. REV. 931, 938-41 (1975); GRAETZ & SCHENK, *supra* note 107, at 39 ("Wage taxes exempt from taxation capital and the income from capital, and consumption taxes sometimes are viewed as similar in this regard.").

175. See *supra* note 174. Cf. Eugene Steuerle, *Back-Loaded IRAs: Head Taxes Replace Income and Consumption Taxes*, 77 TAX NOTES 109 (1997) (two individuals earning the same wages and investing in a Roth IRA will pay the same amount of taxes even though the first individual is not successful with the investments in the Roth IRA and the second individual is wildly successful; Roth IRAs are not income or consumption taxes but rather head taxes); McDANIEL, *supra* note 162, at 257 ("[T]he highly successful investor, who derives higher income from the Roth IRA investment pays the same tax on earned income (and no tax on investment income) as the unsuccessful investor."); GRAETZ & SCHENK, *supra* note 107, at 747 ("If investment yields are not constant, the Roth IRA has the curious effect of taxing two individuals with wildly different amounts of income at the same rate.").

dividends, interest, and capital gains would not be taxed under a wage tax system. The United States currently has a wage tax in the form of federal employment taxes such as the Federal Insurance Contributions Act ("FICA") tax.¹⁷⁶ The FICA tax is composed of two parts: the old-age, survivors, and disability insurance component (generally referred to as the social security tax), and the hospital insurance component (generally referred to as the Medicare tax).¹⁷⁷ The social security component of the FICA tax is imposed on an employee's wages at 12.4% up to a limit of \$94,200 of wages for the year 2006.¹⁷⁸ Wages in excess of \$94,200 (for 2006) are not subject to the social security tax. The Medicare component is imposed on an employee's wages at 2.9% with no wage limit.¹⁷⁹ The FICA tax applies solely to wages and not to income from capital, and therefore, it is a type of wage tax.

The United States also has, in essence, a wage tax with respect to certain retirement savings. In 1997, Congress enacted the Roth Individual Retirement Account ("IRA"), named after the late Senator William Roth of Delaware.¹⁸⁰ In a Roth IRA, an individual contributes amounts into a savings account.¹⁸¹ No deduction is permitted for the contributions;¹⁸² however, income earned by the Roth IRA is not subject to tax, and amounts removed from the account, assuming certain requirements are met, are not subject to tax.¹⁸³ For example, assume an individual earns wages of \$5,000, paying \$1,000 in taxes to the government (i.e., 25% marginal tax rate). The individual places the remaining \$4,000, after-taxes, in a Roth IRA. The \$4,000 will grow tax-free, and when the individual removes the amount, say upon retirement, it will not be subject to tax. The only taxes paid by the individual were on the wages of \$5,000.

A number of recent changes to the U.S. income tax system have led some to believe (from early 2003) that our tax system has subtly shifted from a primarily income-based tax system to a more consumption-based (or wage-based) tax system.¹⁸⁴ This may be a shift intended by the Bush Administration.¹⁸⁵ To illustrate, in 2001, Congress increased the maximum amounts that can be contributed into qualified retirement plans, such as traditional IRAs, Roth IRAs, and 401(k) plans, as well as introduced new qualified retirement plans such as the Roth 401(k) and Roth 403(b) plans.¹⁸⁶ For regular IRAs and Roth IRAs, the annual contribu-

176. See GRAETZ & SCHENK, *supra* note 107, at 39 ("The federal employment taxes are the most significant wage taxes levied in the United States.").

177. I.R.C. §§ 3101, 3111 (West 2002 & Supp. 2005).

178. I.R.C. § 3101(a) (employee's share); I.R.C. § 3111(a) (employer's share).

179. I.R.C. § 3101(b) (employee's share); I.R.C. § 3111(b) (employer's share).

180. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 302(a), 111 Stat. 788, 825-28 (adding § 408A).

181. I.R.C. § 408A(c) (West 2002).

182. I.R.C. § 408A(c)(1).

183. I.R.C. § 408A(d).

184. See *supra* note 153.

185. *Id.*

186. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 611(d)(1), 115 Stat. 38, 97-98 (adding § 402A, effective January 1, 2006).

tion amounts were increased from \$2,000 to \$3,000 in years 2002 through 2004, \$4,000 in years 2005 through 2007, and \$5,000 in years 2008 and after.¹⁸⁷ For 401(k) plans, the annual exclusion of elective deferrals was increased from a base amount of \$7,000 (indexed for inflation—\$10,500 in 2001) to \$11,000 in 2002, \$12,000 in 2003, \$13,000 in 2004, \$14,000 in 2005, and \$15,000 in years 2006 and after.¹⁸⁸ Traditional IRAs and 401(k) plans are based on consumption tax models, and the Roth IRA, Roth 401(k) plans, and Roth 403(b) plans are based on wage tax models. By increasing the contribution limits for these plans, a greater amount of savings are effectively exempt from tax.

In 2003, Congress lowered the maximum tax rate on net capital gains from 20% to 15%.¹⁸⁹ In some cases, the rate is only 5%, which is scheduled to be reduced to zero for taxable years beginning after 2007.¹⁹⁰ In addition, also as part of the 2003 Act, the top tax rate for dividends was reduced from 35% to 15%, equaling the top tax rate for net capital gains.¹⁹¹ As a result, two types of capital income are taxed much more favorably than wages or services income, thereby moving the tax system closer to a wage tax system.

The Bush Administration has also proposed two types of savings accounts, each of which is similar to a Roth IRA and therefore consistent with a wage tax.¹⁹² The first proposal is to consolidate traditional IRAs and Roth IRAs into a single type of account called a Retirement Savings Account (“RSA”). An individual would be permitted to make annual contributions of the lesser of \$5,000 or the individual’s compensation for the year. The contributions would not be deductible. Earnings on contributions would accumulate tax-free and amounts withdrawn from RSAs would, assuming certain requirements are met, be excluded from gross income.

The second proposed savings account is called a Lifetime Savings Account (“LSA”). An individual would be permitted to make up to \$5,000 of contributions to an LSA regardless of the individual’s compensation for the year. Again, the contributions would not be deductible, but the earnings on the contributions would accumulate tax-free and would be excluded from gross income when withdrawn.

The Bush Administration and Congress have also been promoting the idea of permitting businesses to more quickly depreciate equipment, even suggesting that the cost of equipment should be immediately deducted (that is, expensed). This action would be consistent with a consumption

187. *Id.* § 601(a), 115 Stat. at 93-94.

188. *Id.* § 611(d)(1), 115 Stat. at 97-98.

189. I.R.C. § 1(h) (West 2002 & Supp. 2005) (as amended by the 2003 Act).

190. I.R.C. § 1(h)(1)(B).

191. I.R.C. § 1(h)(11).

192. See STAFF OF THE J. COMM. ON TAXATION, 108TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2005 BUDGET PROPOSALS 13-25 (Comm. Print 2004). President Bush’s fiscal year 2004 budget proposals included similar proposals for RSA and LSA. However, the earlier proposals had an annual contribution limit of \$7,500 for the RSA or LSA.

tax in which all investments would be immediately deducted so that a business could expense the cost of its equipment.¹⁹³ In the 2002 Act, Congress enacted a bonus depreciation provision permitting businesses to immediately deduct 30% of the cost of qualified property.¹⁹⁴ One year later, as part of the 2003 Act, Congress increased the bonus depreciation provision to 50% of the cost of qualified property.¹⁹⁵ Also, as part of the 2003 Act, Congress increased the section 179 bonus depreciation from \$25,000 to \$100,000 per taxable year.¹⁹⁶

As a result of these depreciation changes, many businesses could expense the entire cost or a large percentage of the cost of equipment. For example, assume a small business purchased equipment for the year totaling \$100,000. By utilizing the section 179 bonus depreciation, the business could expense the entire cost of the equipment. Assume a medium-sized business purchased equipment for the year totaling \$300,000 and the equipment has an applicable recovery period of seven years. By utilizing the section 179 bonus depreciation, the 50% bonus depreciation, and accelerated depreciation, the business can immediately deduct \$214,286 (\$100,000 + \$100,000 + \$14,286), or approximately 71% of the cost of the equipment. The combination of section 179 bonus depreciation, 50% bonus depreciation, and accelerated depreciation led the tax system closer to expensing equipment and therefore closer to a consumption-tax system. The 50% and 30% bonus depreciation provisions have expired since enactment in 2003 and 2002, respectively, although Congress has extended the \$100,000 limit for the section 179 bonus depreciation through 2007.¹⁹⁷

Some prominent tax commentators have noted the apparent strategy in shifting from an income-based tax system to a consumption-based (or wage-based) tax system.¹⁹⁸ And, in one case, the commentator admitted that it deceived him at the outset.¹⁹⁹ But the tax changes with respect to reducing the tax rate on dividends and capital gains, increasing the contri-

193. See, e.g., GRAETZ & SCHENK, *supra* note 107, at 291 ("Under a consumption tax, all investments would be immediately deductible; consumption would be determined by subtracting all savings and investments from all receipts."); ECONOMIC REPORT OF THE PRESIDENT, *supra* note 153, at 205-06; PRESIDENT'S ADVISORY PANEL REPORT, *supra* note 3, ch. 7.

194. I.R.C. § 168(k) (West 2002 & Supp. 2005).

195. I.R.C. § 168(k)(4).

196. I.R.C. § 179(b)(1). The \$100,000 limitation on the § 179 deduction for any taxable year is reduced by the amount by which the cost of § 179 property placed in service during the year exceeds \$400,000. I.R.C. § 179(b)(2).

197. The \$100,000 limitation and \$400,000 threshold under § 179 are indexed for inflation each year. I.R.C. § 179(b)(5). In 2006, for example, the amounts are \$108,000 and \$430,000, respectively. See Rev. Proc. 2005-70, 2005-47 I.R.B. 979.

198. See, e.g., Bartlett, *supra* note 153; Norquist, *supra* note 153; William G. Gale & Peter R. Orszag, *Bush Administration Tax Policy: Summary and Outlook*, 105 TAX NOTES 1279, 1282 (2004) ("Instead, the tax cuts enacted to date and the proposed additional changes would move the system toward a wage tax . . ."). But see Andrews, *supra* note 153.

199. See Bartlett, *supra* note 153 ("If so [covertly shifting to a flat rate consumption tax system], it will be testament to a very clever, yet bold strategy that was initially invisible even to people like me, who study such things for a living.").

bution limits on retirement plans, and accelerating depreciation deductions, have been enacted in a completely open manner—taxpayers and tax advisors simply did not realize or understand the big picture consequences of the changes.

One of the problems with a piecemeal approach in moving the tax base from an income base to a consumption base is that retaining elements of both systems can lead to some unintended consequences. For example, in 1948, Dr. Cary Brown wrote that “[i]f [expensing of investments is] applied to debt-financed assets [along with deduction of interest payments], it would raise investment incentives above their pretax level.”²⁰⁰ In other words, expensing coupled with an interest deduction on debt-financed investments yields an effective tax rate of less than zero.²⁰¹ If the tax system were to permit full expensing of investments, it appears that the issue of debt-financed investments will need to be addressed.²⁰² Allowing an interest deduction, excluding loan proceeds from income, and utilizing economic (or Samuelson) depreciation are hallmarks of an income tax system.²⁰³ In contrast, allowing expensing of investments is the cornerstone of a consumption tax system. As a result, it would probably be unwise to retain a full interest deduction and also allow expensing of investments.²⁰⁴

A second problem with a piecemeal approach is that some of the more recent changes have moved the tax system closer to a consumption-based tax system while other changes have moved the tax system closer to a wage-based tax system. Under certain assumptions, a consumption tax is equivalent to a wage tax.²⁰⁵ In both types of tax systems, income from

200. Brown, *supra* note 174, at 314.

201. *See id.*

202. *See generally* Martin J. McMahon, Jr., *Reforming Cost Recovery Allowances for Debt Financed Depreciable Property*, 29 ST. LOUIS L.J. 1029 (1985).

203. Economic depreciation, sometimes referred to as Samuelson depreciation, focuses on the decline in the value of the property from year to year. In making this determination, a comparison is made between the present value at the beginning of the year of the net cash flows expected that year and all future years from the property and the present value of the net cash flows from the property at the end of the year. The difference between the two amounts represents economic depreciation for the year. *See, e.g.*, Paul Samuelson, *Tax Deductibility of Economic Depreciation to Insure Invariant Valuations*, 72 J. POL. ECON. 604 (1964); BITTKER & LOKKEN, *supra* note 62, ¶ 23.1.4, at 23-10 to 23-13; MARVIN CHIRELSTEIN, *FEDERAL INCOME TAXATION* ¶ 6.09 (10th ed. 2005).

204. *See, e.g.*, PRESIDENT'S TAX ADVISORY PANEL REPORT, *supra* note 3, ch. 7 (under the Growth and Investment Tax Plan, businesses would expense their capital expenditures and would not be entitled to deduct interest paid); Calvin H. Johnson, *Soft Money Investing Under the Income Tax*, 1989 ILL. L. REV. 1019, 1067 (“Thus, one can argue that the interest payments on debt used to purchase or carry expensed investments should not be deductible.”). *But see* BITTKER & LOKKEN, *supra* note 62, ¶ 52.2.3 (“Disallowance of deductions for interest on debt financing depreciable property thus would likely increase the inefficiencies resulting from accelerated depreciation.”).

205. *See supra* note 174. The following list of assumptions is taken from Professors Michael Graetz's and Deborah Schenk's treatment of the subject in their textbook. First, the applicable tax rates must remain constant. The tax rates can neither increase nor decrease over the time period in question. Second, the deduction must produce an immediate tax savings equal to the deduction multiplied by the taxpayer's marginal tax rate. Third, the tax savings is assumed to be invested at a rate of return equal to the original

capital is generally not taxed. However, if the assumptions are relaxed, then a consumption tax becomes quite different from a wage tax. For example, one of the assumptions in demonstrating the equivalence is that of constant tax rates.²⁰⁶ In the U.S. tax system, there are progressive tax rates, and as a result, the equivalence between consumption and wage taxes breaks down.²⁰⁷ With the expiration of many of the accelerated depreciation provisions enacted in 2002 and 2003, which were evidence of a consumption tax system, it would probably be more accurate to state that the tax system has shifted closer to a wage tax system rather than a consumption tax system.²⁰⁸

Simply to confuse people is no great accomplishment, but to cover up what is really done and at the same time to make people see something absolutely different and be positive about it, requires great ability, resourcefulness and tireless practice.

— John Northern Hilliard²⁰⁹

VII. REFLECTIONS ON GIMMICKS AND FAKES IN TAX LAW

In adopting the magic classifications of gimmicks and fakes with respect to tax legislation, one discovers that Congress utilizes both types of devices in enacting tax legislation. However, Congress's use of rifle-shot transition rules and ad hoc provisions, which are, in essence, tax gimmicks, appears to have declined since the 1986 Act, which contained hundreds of these provisions.²¹⁰ Congress occasionally places a hidden tax break in the legislative history, also a tax gimmick, as it apparently did for Starbucks in 2004.²¹¹

Congress's use of the alternative minimum tax to reduce the revenue cost of tax provisions, thereby using the AMT as part of a fake, appears to continue to the current day. In fact, just last year, Congress enacted three new consumer energy credits that are not creditable for purposes of the AMT.²¹² As a result, many taxpayers will not receive the full tax benefit from the credits, thereby lowering the revenue cost of the credits. One reason why the AMT is used successfully in reducing the revenue costs of tax provisions may be due to the complexity of the tax laws. Many taxpayers and tax advisors simply cannot grasp many of the intricacies of the tax laws to thoroughly understand the interaction between va-

investment, and the opportunities to invest at the assumed rate of return are unlimited. See GRAETZ & SCHENK, *supra* note 107, at 293.

206. GRAETZ & SCHENK, *supra* note 107, at 293.

207. See generally Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807 (2005) (progressive tax rates destroy the equivalence between prepaid (that is, wage) and postpaid consumption taxes).

208. See Gale & Orszag, *supra* note 198, at 1282 ("Instead, the tax cuts enacted to date and the proposed additional changes would move the system toward a wage tax . . .").

209. HILLIARD, *supra* note 22, at 721.

210. See *supra* note 44-45 and accompanying text.

211. See *supra* notes 72-79 and accompanying text.

212. See *supra* note 148.

rious provisions. The previous statement is not meant to denigrate tax advisors, but rather to illustrate how complex the tax laws have become. By enacting tax legislation that interacts with the AMT, Congress is able to achieve certain results that many taxpayers and advisors do not thoroughly understand.

In addition, many taxpayers (and tax advisors) do not understand the differences between an income tax system and a consumption tax (or wage tax) system even though there appears to be a lot of opposition in shifting to a consumption tax system. By simply proposing cuts in the taxation of capital income, expanding depreciation deductions, and expanding retirement savings, Congress (and the Bush Administration) is able to win public support as most taxpayers welcome such changes as reducing their tax liability, not realizing that such changes move the tax system closer to a consumption tax (or wage tax) system.²¹³

There are a number of other provisions in the tax law that some commentators would refer to as gimmicks, trickery, or sleight of hand. In many of these cases, the tax provisions do not fit neatly into the gimmick or fake classifications. For example, income phase-outs, in which tax benefits under a particular provision are phased out as taxpayers earn a higher income, may be referred to by some as a gimmick or trickery. But, in many cases, the income phase-outs may be designed to provide a tax benefit to a particular category of taxpayers, such as low-income or middle-income taxpayers, or may simply be enacted to lower the revenue cost of a particular tax provision. In many cases, these provisions are highly visible and generally understood by taxpayers and tax advisors.

Conjuring is the only absolutely honest profession: a conjuror promises to deceive and does.

— Karl Germain, lawyer and magician²¹⁴

VIII. CONCLUSION

Those involved in the tax legislative process have been accused of engaging in sleight of hand with respect to tax legislation by utilizing, in magical terminology, primarily gimmicks and fakes. Tax gimmicks would include items such as rifle-shot transition rules, ad hoc provisions, and provisions contained in the legislative history to benefit a particular taxpayer. These are all items that are hidden from general view in the sense that they are not part of the Code but provide a tax benefit to a particular

213. See Warren Vieth, *The Nation*; *U.S. Tax Code May Be Facing a Full Rewrite*, L.A. TIMES, Nov. 7, 2004, at A27 (“In the last four years there were four tax cuts,” said [Grover] Norquist of Americans for Tax Reform. “People looked at those and thought they were just catch as catch can. But every one of those tax cuts moved us toward a single-rate tax system that taxes income just one time.”).

There are numerous other provisions in the current tax system that are consistent with a consumption tax or wage tax. See generally Deborah H. Geier, *The Taxation of Income Available for Discretionary Use*, 25 VA. TAX REV. 765, 769 (2006).

214. CRAMER, GERMAIN THE WIZARD, *supra* note 23, at 237.

taxpayer or a very limited number of taxpayers. In contrast, tax fakes are open and visible tax provisions that accomplish a purpose not understood by taxpayers. As a general rule, tax fakes appear to affect millions of taxpayers even though they may not understand how it affects them. For example, the AMT takes back some of the tax benefits of a number of tax provisions but very few taxpayers understand how it accomplishes that result.

In the last few years, the Bush Administration and Congress have proposed and enacted a number of changes to the tax laws that are fairly sweeping in their coverage, such as lowering the maximum tax rates on dividends and net capital gains and increasing the limits for contributions to qualified retirement plans. Rather than affecting a very limited number of taxpayers, these recent changes affect millions of taxpayers. However, these changes appear to have taken place in a manner not thoroughly understood by taxpayers aside from the immediate tax savings, and therefore such changes could be classified as a tax fake. For example, lowering the taxation of income from capital, increasing contribution limits for retirement savings, and increasing expensing of investments all lower taxes; as a result, they are almost universally supported by taxpayers who, in many cases, do not realize the big picture consequences of these changes.²¹⁵ Because of these changes, however, the U.S. tax system appears to be shifting from an income tax system to a consumption tax (or wage tax) system—in full view of the audience.

ADDENDUM

In 1998, the Supreme Court held the Line Item Veto Act of 1996 unconstitutional; however, Congress is currently considering several bills that would, in essence, resurrect the line-item veto, in a slightly different form, authorizing the President to cancel or rescind “targeted tax benefits” (those tax provisions benefitting a limited number of taxpayers).

215. *See supra* note 213.